DEVELOPING A MARKET FOR EMPLOYMENT DISCRIMINATION CLAIMS IN THE SECURITIES INDUSTRY

Paul Rose*

Mandatory arbitration has become the securities industry's preferred means of resolving statutory employment discrimination disputes. However, as arbitration has grown in popularity, it has come under increasingly intense scrutiny from employee advocates and federal regulators. Regulators, lawyers, judges, and scholars continue to grapple with the problem of balancing the benefits of arbitration—speed, finality, and cost-effectiveness—against concerns over the fairness of arbitration as it is practiced. In this Comment, Paul Rose analyses the mandatory arbitration debate within the framework of regulatory competition theory. He argues that as a legal product, arbitration generally fails to attract claimants who have a choice between arbitration and the courts. He then discusses ways in which arbitration providers may improve arbitral systems to ensure that arbitration remains a viable option for claimants.

INTRODUCTION 400
I. THE BENEFITS AND BURDENS OF ARBITRATION 402
  A. Public Policy Concerns 403
  B. The Securities Industry Arbitral Framework 407
    1. A History of Arbitration in the Securities Industry 407
    2. Criticisms of Securities Industry Arbitration 410
II. THE ELIMINATION OF MANDATORY ARBITRATION 411
  A. The NASD Rule Changes 413
  B. Response to the Rule Changes 414
    1. Solicited Comments 415
  C. The NYSE Follows 417
    1. The NYSE Proposal Letter 417
  D. Concerns with Both Models 417
III. THE MARKET FOR CLAIMS 418
  A. A Securities Industry Regulatory Co-Opetition Model 420

* Chief Articles Editor, UCLA Law Review, Volume 48. J.D. candidate, UCLA School of Law, 2001. B.A., Brigham Young University, 1995. Many thanks to Professor Gillian Lester for her dedicated work as an advisor and editor. Thanks also to Jean Feeney of the NASD Regulation for her guidance on the NASD's efforts to improve their arbitral forum. And, of course, thanks to Tricia Keane, Shira Roth, Mark Takla, and the staff of the *UCLA Law Review* for their work in improving this Comment. All errors are Tricia's. I dedicate this Comment to Traci, Emma, and William for their love and support.

1. Interforum Competition: Attracting Claims Among Industry Competitors ... 420
2. Intraforum Competition: Departments Within the Firm ... 422
3. Extraforum Competition: The Courts and Arbitration Systems ... 422

IV. THE NASD REVISION: A COMPETITIVE RESPONSE ... 424
A. The NASD Arbitration Improvements ... 424
1. Amendments to the NASD Code of Arbitration ... 426
a. Arbitrator Qualifications ... 426
b. Awards ... 427
c. Coordination of Claims ... 428
d. Disclosure When Signing Form U-4 ... 429
e. Discovery ... 429
f. Attorney's Fees ... 430
B. Arbitration System Improvements Among Securities Firms ... 431

V. REMAINING CONCERNS: MARKET FAILURES AND MARKET PROTECTIONS ... 433
A. The Appropriateness of a Market Response ... 434
B. The Problem of Imperfect Information ... 435
1. Predispute Information ... 435
2. Postdispute Information ... 438
C. Too Few Competitors in the Marketplace ... 438
D. Lack of Mobility ... 439
E. Excessive Regulation ... 441

CONCLUSION ... 442

INTRODUCTION

If "law is a product,"[1] and arbitration and litigation are types of legal products available to claimants, arbitration will function more efficiently if it competes for claims within a market environment. Until very recently, however, securities industry employees bringing statutory discrimination claims have not had the opportunity to go "forum shopping"[2] for the most attractive legal product; for the better part of a decade, arbitration has not been

1. Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225 (1985).

2. While I borrow some central language from the theory of regulatory competition, the market theory discussed in this Comment differs from traditional regulatory competition models in that it incorporates a vertical structure of competition, rather than focusing only on a horizontal structure of competition. A vertical structure of competition is industry arbitration and nonindustry arbitration, while a horizontal structure of competition is competition between the states. This revised model owes more to Dan Esty and Damien Geradin's recent work on "regulatory co-opetition," concerning complex, multilayered regulatory schemes in which vertical and horizontal competition and cooperation achieve greater market efficiency than could horizontal forum competitors. *See* Daniel C. Esty & Damien Geradin, *Regulatory Co-Opetition*, 3 J. INT'L ECON. L. 235 (2000).

"just another forum"[3] for securities industry employment discrimination claimants. Because employees sign mandatory arbitration agreements as a condition of employment with securities firms, arbitration has been the only dispute resolution system available to most employee claimants. However, in 1998, the Securities and Exchange Commission (SEC or Commission) approved rule changes that remove the mandatory arbitration clauses from the National Association of Securities Dealers (NASD) and the New York Stock Exchange (NYSE) arbitration codes, a move that restores an employee's right to pursue employment discrimination claims in court. To the extent that arbitration does not operate efficiently in the market—that is, compete successfully with the courts and other fora for claims—it must reinvent itself in order to offer a competitive alternative. Indeed, since the NYSE and NASD rule changes, securities industry arbitration has undergone many changes that bring it closer to the standards of arbitration offered outside of the industry. Although securities industry arbitration has not yet transformed itself into a strong competitor with the courts for employment discrimination disputes, the new market for these claims has brought about some important procedural changes in industry arbitration.

The extensive literature on mandatory arbitration of securities industry employment claims[4] has largely focused on the case law[5] that serves as the basis

3. *Mandatory Arbitration Agreements in Employment Contracts in the Securities Industry: Hearing Before the Senate Comm. on Banking, Hous. & Urban Affairs*, 105th Cong. 18 (1998) [hereinafter *Hearing*] (statement of Cliff Palefsky, Chairman, Sec. Indus. Arbitration Comm.).

4. *See, e.g.*, Reginald Alleyne, *Statutory Discrimination Claims: Rights "Waived" and Lost in the Arbitration Forum*, 13 HOFSTRA LAB. L.J. 381 (1996); Norris Case, *Arbitration of Workplace Discrimination Claims: Federal Law and Compulsory Arbitration*, 14 TOURO L. REV. 839 (1998); Sarah Rudolph Cole, *Incentives and Arbitration: The Case Against Enforcement of Executory Arbitration Agreements Between Employers and Employees*, 64 UMKC L. REV. 449 (1996); Joseph I. Goldstein & Martin F. Payson, *Compulsory Arbitration: Are Mandatory Agreements to Arbitrate Employment Disputes Enforceable Under Current Law?*, 1 J. ALTERNATIVE DISP. RESOL. EMP. 40 (1999); Leona Green, *Mandatory Arbitration of Statutory Employment Disputes: A Public Policy Issue in Need of a Legislative Solution*, 12 NOTRE DAME J.L. ETHICS & PUB. POL'Y 173 (1998); David S. Schwartz, *Enforcing Small Print to Protect Big Business: Employee and Consumer Rights Claims in an Age of Compelled Arbitration*, 1997 WIS. L. REV. 33.

5. Some of the more important arbitration-related cases include *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 35 (1991) (compelling arbitration of an age discrimination claim pursuant to a mandatory arbitration agreement signed during registration with the New York Stock Exchange (NYSE)); *Rodriguez de Quijas v. Shearson/American Express Inc.*, 490 U.S. 477, 480 (1989) (holding that claims under the Securities Act of 1933 may be arbitrated); *Perry v. Thomas*, 482 U.S. 483, 492 (1987) (holding that the Federal Arbitration Act required a securities firm employee to arbitrate his statutory wage claim against his employer, pursuant to the mandatory arbitration agreement signed during his registration with the NYSE); *Shearson/American Express Inc. v. McMahon*, 482 U.S. 220, 238, 242 (1987) (holding that claims under the Securities Exchange Act of 1934 and under the Racketeer Influenced and Corrupt Organization Act could be arbitrated); and *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 627 (1985) (holding that claims under the Sherman Antitrust Act may be arbitrated).

for arbitration. This critical body of work, the product of professors, students, and employee advocates, has increased awareness of the shortcomings of the securities industry arbitration system, and has guided policymakers in crafting fairer arbitral frameworks. Another, smaller body of work has appeared in response,[6] principally the work of practitioners who counsel securities firms, that focuses on the benefits of arbitration for employees as well as employers.

Because arbitration of employment discrimination claims was (and to some degree still is, as I discuss) mandatory for industry employees, these analyses have predominantly focused on the legality, appropriateness, and fairness of arbitration. Rather than discussing the merits of arbitration as an isolated forum, however, this Comment sketches out an analysis of securities industry arbitration as a competitive market product, and discusses how arbitration must evolve in this new market to compete successfully for employment-related claims.

In Part I, this Comment looks at the benefits and burdens of securities industry arbitration (offering a brief but essential background to the topic), tracing the development of arbitration in the securities industry. In Part II, this Comment focuses on the NASD's and the NYSE's elimination of mandatory arbitration. In Part III, this Comment introduces the market for claims enabled by the elimination of mandatory arbitration, and in Part IV, it notes the recent changes in securities industry arbitration resulting from the new market for claims. In Part V, this Comment considers the remaining obstacles to optimal performance of the claims market. It then offers conclusions on the further development of the claims market, noting that the regulatory co-opetition model that this Comment introduces relies on the federal government to play an active role in ensuring a competitive employment discrimination claims market.

I. THE BENEFITS AND BURDENS OF ARBITRATION

Arbitration has gained popularity as a faster, cheaper, and generally less disruptive[7] means of dispute resolution. Not surprisingly, some of the most ardent proponents of arbitration are judges, who see arbitration and other forms

6. *See, e.g.*, Michael V. Abcarian & Michael E. Coles, *Don't Abandon Arbitration Clauses*, TEX. LAW., May 24, 1999, at 23, WL 5/24/1999 TEXLAW 23; Gail Diane Cox, *Arbitration Is No Simple Matter*, NAT'L L.J., June 28, 1999, at A1.

7. Arbitration may be less disruptive because it is generally less adversarial. Employees might be able to continue working without the rift between the employer and the employee that often develops in litigation. Thus, an employee whose claim is in arbitration, rather than litigation, might not feel compelled to leave the workplace as would normally be the case with a litigated dispute. However, this would probably not be the case when the employee asserts a statutory claim against an employer, or when the hostility of the work environment was already so unbearable as to necessitate the filing of a claim.

of alternative dispute resolution as a means of reducing the number of cases on their dockets.[8] Chief Justice Warren E. Burger noted that arbitration is an effective tool for removing large cases and large classes of cases from the docket.[9]

Supporters of arbitration also argue that arbitration offers better access to justice for the economically disadvantaged,[10] because many persons cannot afford litigation's costs in time and money.[11] One immediate advantage in bringing a claim to arbitration is the lack of procedure and formality that necessitates legal counsel in a litigated dispute.[12]

Despite the advantages of arbitration, detractors of arbitration as practiced in the securities industry have found much to criticize. These criticisms fall into two broad categories: public policy concerns and securities industry forum concerns. The first group of criticisms attacks mandatory arbitration of employment discrimination claims generally. The second group of criticisms attacks the specific failures of securities industry arbitration.

A. Public Policy Concerns

The Equal Employment Opportunity Commission (EEOC) complains that mandatory arbitration of employment discrimination disputes "privatizes" enforcement of federal employment discrimination laws.[13] The initial question

8. As Sarah Rudolph Cole notes, "the growth in federal court litigation has not been accompanied by an increased allocation of resources, particularly in the area of judicial appointments. The assumption apparently has been that judges are capable of producing the same quality of work even when their workload increases exponentially." Cole, *supra* note 4, at 449 (footnote omitted).

9. *See* Warren E. Burger, *Isn't There a Better Way?*, 68 A.B.A. J. 274, 277 (1982).

10. For example, "many blue collar and non-managerial claimants are unable to secure counsel, who are often reluctant to enter into a contingent fee arrangement with an employee whose potential recovery does not justify the substantial time and expense called for in discovery-intensive discrimination cases." John W.R. Murray, Note, *The Uncertain Legacy of* Gilmer*: Mandatory Arbitration of Federal Employment Discrimination Claims*, 26 FORDHAM URB. L.J. 281, 296 (1999); *see also* Theodore J. St. Antoine, *Mandatory Arbitration of Employee Discrimination Claims: Unmitigated Evil or Blessing in Disguise?*, 15 T.M. COOLEY L. REV. 1, 7–8 (1998).

11. However, Cliff Palefsky has argued that "the costs to an employee to vindicate his or her rights in the arbitration forum are exorbitant, despite industry rhetoric to the contrary." *Hearing*, *supra* note 3, at 79 (statement of Cliff Palefsky). Palefsky notes that filing a claim in a federal court requires an initial filing fee of $150, whereas filing a claim with industry arbitration requires a $500 filing fee, plus forum fees of $1500 to $3000 per day. *See id.* Forum fees are "routinely in excess of $20,000, and several have been in excess of $40,000, $60,000, or even, as in the case of *Wolfe v. Schwab*, $82,000." *Id.*

12. Arbitration is becoming increasingly complex. Therefore, arbitration may not be the haven from lawyers that some may have hoped. *See* Cox, *supra* note 6.

13. *See EEOC Policy Statement on Mandatory Binding Arbitration*, EEOC Notice 915.002, at 6, *available at* http://www.eeoc.gov/docs/mandarb.html (last modified July 6, 2000) [hereinafter EEOC Notice]; *see also Motions on Alternative Dispute Resolution Adopted by EEOC April 25, 1995*, 80 Daily Lab. Rep. (BNA) E-1 (Apr. 26, 1995).

for the EEOC, then, is not whether the securities industry's arbitration framework adequately protects the rights of employees, but whether any private industry has the authority to mandate arbitration of statutory employment discrimination disputes. The EEOC contends that "Congress explicitly entrusted the primary responsibility for the interpretation, administration, and enforcement of these standards, and the public values they embody, to the federal government."[14] Also implicit in this declaration is the understanding that the government agencies created by Congress to monitor employment discrimination issues should have sole enforcement jurisdiction (as opposed to oversight by the SEC). The EEOC points out that Congress created the EEOC to investigate and conciliate claims of discrimination and to interpret the law. Further, Congress gave it litigation authority to bring cases to court that the EEOC could not administratively resolve.[15] Congress also granted enforcement authority to the U.S. Department of Justice, which litigates cases involving state and local governments.[16] Finally, aggrieved individuals act as "private attorneys general."[17] The private civil rights plaintiff serves not only her own private interests, but also serves Congress by vindicating a policy that Congress considered of the "'highest priority.'"[18]

Critics note that the very factors that make arbitration so attractive (low cost, speed, and informality) bypass crucial procedural safeguards and basic rights.[19] Among the basic rights given up by an employee who agrees or is compelled to arbitrate is the right to a jury trial. The Civil Rights Act of 1991[20] ensured employees that a jury would decide factual issues (the question of "[w]hat did the employer do to the employee?"[21]) and damage issues. Arbitration, by contrast, gives all factual, legal, and damage issues to the arbitrators.[22] In addition, litigation typically affords an employee broader discovery than arbitration. The goal of the arbitration forum is to resolve the dispute as quickly and inexpensively as possible, and to achieve this goal, the arbitration

14. EEOC Notice, *supra* note 13.
15. *See id.*
16. *See id.*
17. *Id.*
18. *Id.* (quoting Newman v. Piggie Park Enters., Inc., 390 U.S. 400, 402 (1968)).
19. *See* Judith Resnik, *Failing Faith: Adjudicatory Procedure in Decline*, 53 U. CHI. L. REV. 494, 544–46 (1986) (arguing that the focus of arbitration—speed and low cost—ignores important procedural protections).
20. Pub. L. No. 102-166, 105 Stat. 1074 (1991) (codified at 42 U.S.C. § 2000e (1994)).
21. RICHARD A. BALES, COMPULSORY ARBITRATION: THE GRAND EXPERIMENT IN EMPLOYMENT 147 (1997).
22. As noted by Richard Bales, employers prefer to have judges or arbitrators decide these questions because (1) arbitrators and judges are seen as more predictable than juries; (2) employers perceive jurors as the employees' peers, rather than the employers' peers, so are more likely to side with the employee in disputes; and finally (3) employers believe that jurors are more likely to award "jackpot" sums than are judges or arbitrators. *See id.* at 147–49.

claimant will be subject to discovery rules designed to minimize the time and effort necessary to resolve the claim.[23] However, the employee bringing a Title VII claim (an employment discrimination claim under the Civil Rights Act) to court will typically receive generous access to employer information in order to establish a case,[24] thus improving the claimant's chances for success. Broad discovery might also be valuable to an employer,[25] but employers typically do not depend on discovery to the extent that employees do.[26]

Another frequent complaint is that arbitrators' decisions are not appealable, except when the possibility of an appeal is incorporated in the contract, thereby eliminating a check against anomalous decisions and procedural errors.[27] Critics argue that because arbitration is private in nature, there is little public accountability.[28] As the EEOC notes, "The lack of public disclosure not only weakens deterrence, but also prevents assessment of whether practices of individual employers or particular industries are in need of

23. In arbitration, the emphasis is on efficient resolution of the dispute, rather than "preventing and deterring discrimination and . . . making discrimination victims whole." EEOC Notice, *supra* note 13 (capitalization removed).

24. Under Federal Rules of Civil Procedure Rule 26(b)(1), the information sought "need not be admissible at the trial if [it] appears reasonably calculated to lead to the discovery of admissible evidence." FED. R. CIV. P. 26(b)(1). Courts construe this phrase broadly to encompass any matter that bears on, or that reasonably could lead to another matter that could bear on, any issue that is or may be in the case. *See* Jackson v. Montgomery Ward & Co., 173 F.R.D. 524, 526 (D. Nev. 1997). In Title VII cases, the court noted that "plaintiffs will often experience difficulty in rebutting with direct evidence an employer's account of its own motives for terminating or rejecting an employee, because '[d]efendants of even minimal sophistication will neither admit discriminatory animus nor leave a paper trial demonstrating it.'" *Id.* at 527 (quoting Riordan v. Kempiners, 831 F.2d 690, 697 (7th Cir. 1987)). Title VII plaintiffs are thus allowed broad discovery in order to reveal circumstantial evidence, because "circumstantial proof may be critical for the jury's assessment of whether a given employer was more likely than not to have acted from an unlawful motive." *Id.* at 528. On the other hand, "arbitration systems are not suitable for resolving class or pattern or practice claims of discrimination . . . [and] may, in fact, protect systemic discriminators by forcing claims to be adjudicated one at a time, in isolation, without reference to a broader—and more accurate—view of an employer's conduct." EEOC Notice, *supra* note 13; *see also Hearing*, *supra* note 3, at 79 (statement of Cliff Palesfky).

25. Employers may use discovery to obtain certain admissions from employees. The employer then uses these admissions to get the case dismissed. *See* BALES, *supra* note 21, at 150.

26. However, employers in the securities industry may take advantage of the lack of evidentiary restrictions that a federal court would normally impose:

> In sexual harassment cases, for example, consensual sexual activity by the plaintiff with persons other than the harasser is excluded under Federal law . . . [y]et an arbitrator in such a case, under no obligation to comply with such an evidentiary restriction, may allow the employer to forage where it desires in a plaintiff's private conduct.

Hearing, *supra* note 3, at 79–80 (statement of Cliff Palefsky).

27. The standard for overturning erroneous arbitration decisions is prohibitively high. A claimant must show that the arbitrator (1) knew the law, (2) found it applicable to the facts of the case, but (3) specifically chose to ignore it. *See id.* at 78 (statement of Cliff Palefsky).

28. "Adjudication is more likely to do justice than . . . arbitration . . . precisely because it vests the power of the state in officials who act as trustees for the public, who are highly visible, and who are committed to reason." Owen M. Fiss, *Out of Eden*, 94 YALE L.J. 1669, 1673 (1985).

reform."[29] Public adjudication highlights patterns of discrimination in companies or industries,[30] while some closed, private arbitration systems ignore the value of public disclosure of discriminatory patterns.

In addition, the informality of arbitration in offering decisions without written, reasoned opinions makes it difficult for courts to correct errors in statutory interpretation. Critics of arbitration argue that because arbitral decisions are not always written, reasoned, and published, arbitration does not build a reliable framework through precedent.[31] Courts give an arbitrator's decision great deference,[32] and usually will not review the arbitrator's decision even when the arbitrator has clearly misapplied a statute or has not relied on otherwise binding precedent. Employee advocates, noting the courts' deference to arbitration, argue that judges are too eager to unload lengthy cases and large classes of cases involving statutory rights, a claim that seems a short step away from accusing judges of sacrificing employee rights for a lighter workload.[33]

Finally, employee advocates argue that the contracts signed by NASD- or NYSE-regulated employees are contracts of adhesion, or are at least exploitative of the employee's weak bargaining position.[34] This argument has not convinced the U.S. Supreme Court, however, which held in *Gilmer v. Interstate/Johnson Lane Corp.*[35] that the typical securities industry "take-it-or-leave-it" contract was not unenforceable simply because the employer exerts

29. EEOC Notice, *supra* note 13 (citation omitted).

30. The U.S. Supreme Court stated:

> The disclosure through litigation of incidents or practices which violate national policies respecting nondiscrimination in the work force is itself important, for the occurrence of violations may disclose patterns of noncompliance resulting from a misappreciation of [Title VII's] operation or entrenched resistance to its commands, either of which can be of industry-wide significance.

McKennon v. Nashville Banner Publ'g Co., 513 U.S. 352, 358–59 (1995).

31. *See* EEOC Notice, *supra* note 13.

32. *See* BALES, *supra* note 21, at 151.

33. *See* Diane P. Wood, *Court-Annexed Arbitration: The Wrong Cure*, 1990 U. CHI. LEGAL F. 421, 430. Even some arbitration proponents would like to limit the type of cases that arbitrators may hear. *See* Jethro K. Lieberman & James F. Henry, *Lessons from the Alternative Dispute Resolution Movement*, 53 U. CHI. L. REV. 424, 432 (1986).

34. The EEOC notes that

> [t]he terms of the private agreement defining the arbitrator's authority and the arbitral process are characteristically set by the more powerful party, the very party that the public law seeks to regulate. We are aware of no examples of employees who insist on the mandatory arbitration of future statutory employment disputes as a condition of accepting a job offer—the very suggestion seems far-fetched. Rather, these agreements are imposed by employers because they believe them to be in their interest, and they are made possible by the employer's superior bargaining power.

EEOC Notice, *supra* note 13.

35. 500 U.S. 33 (1991).

much greater bargaining power.[36] The Court left employees with as much protection as they might receive in relation to any contract: The agreement would not be enforced if it "resulted from the sort of fraud or overwhelming economic power that would provide grounds 'for the revocation of any contract.'"[37] In market terms, the *existence* of market advantages, as described in *Gilmer*, does not necessarily create an inefficient market. The *abuse* of market advantages, however, should elicit action from market watchers and regulators.

B. The Securities Industry Arbitral Framework

Having noted some of the general criticisms of mandatory arbitration, this part focuses on the specific criticisms of securities industry employee arbitration. This Comment first traces the development of arbitration in the securities industry, and it then examines the existing arbitral framework and the criticisms of that framework.

1. A History of Arbitration in the Securities Industry

Arbitration of securities industry disputes began in 1872, when the NYSE instituted an arbitration forum to resolve disputes between member-dealers and customers.[38] The other exchanges followed over the next 100 years.[39] However, arbitration was not used to resolve general employment disputes between industry employers and employees until after the Supreme Court's 1987 decision in *Shearson/American Express, Inc. v. McMahon*.[40] In *McMahon*, the Court upheld the validity of predispute arbitration agreements between brokerage firms and their customers under the Securities Exchange Act, allowing brokerage firms to compel customers to resolve disputes through arbitration. Industry firms were given court approbation to include mandatory arbitration clauses in registration agreements between the employees and the exchanges, using the existing arbitral framework to resolve employment disputes.

36. As noted by the EEOC, "[t]he *Gilmer* decision is not dispositive of whether employment agreements that mandate binding arbitration of discrimination claims are enforceable. As explicitly noted by the Court, the arbitration agreement at issue in *Gilmer* was not contained in an employment contract." EEOC Notice, *supra* note 13, at n.2 (citations omitted).

37. *Gilmer*, 500 U.S. at 33 (quoting Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 627 (1985)).

38. *See* Lewis D. Lowenfels & Alan R. Bromberg, *Securities Industry Arbitrations: An Examination and Analysis*, 53 ALB. L. REV. 755, 769 (1989).

39. The American Stock Exchange followed in 1964, the National Association of Securities Dealers (NASD) in 1968, and the Chicago Board Options Exchange in 1973.

40. 482 U.S. 220, 226–27 (1987).

When an individual accepts employment with an NASD or NYSE member firm, she typically signs a standard employee agreement, with boilerplate employment contract provisions such as nondisclosure clauses and disciplinary clauses, for example. Increasingly, employers are inserting mandatory arbitration clauses into the employment contracts as well.[41]

The Federal Arbitration Act[42] states that self-regulatory organizations like the NASD or the NYSE may "require a natural person associated with a member, or any class of such natural persons, to be registered with the association in accordance with procedures so established [by the rules of the association]."[43] Registration has been mandatory for all associated persons effecting securities transactions since 1993.[44] The NASD, NYSE, and other self-regulatory organizations require all persons associated with a broker-dealer[45] to sign a mandatory arbitration clause, Form U-4, the "Uniform Application for Securities Industry Registration or Transfer."[46] Form U-4 reads:

> I agree to arbitrate any dispute, claim or controversy that may arise between me and my firm, or a customer, or any other person, that is required to be arbitrated under the rules, constitutions, or by-laws of the [self regulatory organizations (SROs)] indicated in Item 11 as may be amended from time to time and that any arbitration award rendered

41. This trend, while receiving most recognition in the securities industry context, has carried over into all types of employment contexts. As the securities industry led the way in imposing mandatory arbitration agreements, the industry is also leading the way in the creation of a market for discrimination claims.

42. Federal Arbitration Act, ch. 392, § 1, 61 Stat. 670–72 (1947) (current version at 9 U.S.C. §§ 1–10 (1994)).

43. 9 U.S.C. § 15A(g)(3)(B).

44. *See* Compliance with Qualification Requirements of Self-Regulatory Organizations, 17 C.F.R. § 240.15b7-1 (2000). The rule provides:

> No registered broker or dealer shall effect any transaction in, or induce the purchase or sale of, any security unless any natural person associated with such broker or dealer who effects or is involved in effecting such transaction is registered or approved in accordance with the standards of training, experience, competence, and other qualification standards (including but not limited to submitting and maintaining all required forms, paying all required fees, and passing any required examinations) established by the rules of any national securities exchange or national securities association of which such broker or dealer is a member or under the rules of the Municipal Securities Rulemaking Board (if it is subject to the rules of that organization).

Id.

45. The term broker or dealer encompasses all exchange-registered representatives, assistant representatives, or principals.

46. FORM U-4, UNIFORM APPLICATION FOR SECURITIES INDUSTRY REGISTRATION OR TRANSFER (rev. Aug. 1999). The Form U-4 was adopted effective October 1, 1975. *See* Self-Regulatory Comm'n Orgs., Exchange Act Release No. 34-39,421, 62 Fed. Reg. 66,164, 66,164 n.4 (Dec. 17, 1997) [hereinafter Release No. 34-39,421].

> against me may be entered as a judgment in any court of competent jurisdiction.[47]

Mandatory arbitration clauses for employment disputes were tested in *Perry v. Thomas*,[48] in which the Supreme Court again upheld the firms' ability to compel arbitration. The Court held that the Federal Arbitration Act[49] required a securities firm employee to arbitrate his statutory wage claim against his employer, pursuant to the arbitration agreement contained in Form U-4.[50]

Perry was followed by the landmark mandatory arbitration case, *Gilmer*, in which the Supreme Court held that claims brought under the Age Discrimination in Employment Act[51] are arbitrable pursuant to the agreement in Form U-4.[52]

---

47. FORM U-4, *supra* note 46, at 4 (emphasis omitted). The Securities and Exchange Commission (SEC or Commission) approved a new version of the Form U-4 on July 5, 1996. *See* Self-Regulatory Orgs., Exchange Act Release No. 34-37,407, 61 Fed. Reg. 36,595, 36,595 (July 11, 1996). The use of the revised form has been deferred pending changes to the Central Registration Depository. *See* Self-Regulatory Orgs., Exchange Act Release No. 34-37,994, 61 Fed. Reg. 64,549, 64,550 (Dec. 5, 1996). Form U-4 thus incorporates the rules of the self-regulatory organization (SRO) with which the individual is to be registered. NASD Rule 10101 provides as follows:

> This Code of Arbitration Procedure is prescribed . . . for the arbitration of any dispute, claim, or controversy arising out of or in connection with the business of any member of the Association, or arising out of the employment or termination of employment of associated person(s) with any member, with the exception of disputes involving the insurance business of any member which is also an insurance company . . . between or among members and associated persons . . . .

NASD, CODE OF ARBITRATION PROCEDURE, Administrative Provision 10101 (1999), *reprinted in* NASD Man. (CCH) 7511 (2000).

48. 482 U.S. 483 (1987).

49. 9 U.S.C. §§ 1–10 (1994).

50. *See Perry*, 482 U.S. at 489. Barclay Perry signed Form U-4, the Uniform Application for Securities Industry Registration or Transfer. *See* Thomas v. Perry, 200 Cal. App. 3d 510, 513 (1988). The exchanges require all exchange registrants to sign the form. *See id.* Form U-4 binds the employee to adhere to the rules and regulations of the SROs. *See id.* It also contains an agreement to arbitrate disputes arising out of the registrant's employment pursuant to the SRO rules. *See id.*

51. Pub. L. No. 90-202, § 2, 81 Stat. 602 (1967) (codified at 29 U.S.C. § 621).

52. *See* Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 33, 35 (1991). The question of the legality of mandatory arbitration for Title VII claims was somewhat complicated with a Massachusetts district court opinion in *Rosenberg v. Merrill Lynch*, 995 F. Supp. 190 (D. Mass. 1998), *aff'd on other grounds*, 170 F.3d 1 (1st Cir. 1999), and the Ninth Circuit's decision in *Duffield v. Robertson Stephens & Co.*, 144 F.3d 1182 (9th Cir.), *cert. denied*, 525 U.S. 996 (1998). The court in *Duffield* held that the Civil Rights Act of 1991 prohibits the imposition of mandatory arbitration agreements in Title VII claims. *See id.* at 1202–03. Some wondered if these cases would lead to the end of mandatory arbitration of Title VII claims.

> A recent spate of federal court opinions, however, has panicked employers and thrown a pall over the way some companies view the future of mandatory arbitration programs. Nervous that the U.S. Supreme Court will rule that binding arbitration clauses are generally unenforceable, employers have been tempted to abandon them.

Abcarian & Coles, *supra* note 6. However, *Duffield* and *Rosenberg* are aberrations—every other circuit except the Sixth Circuit has castigated, or at least dismissed, *Duffield* and *Rosenberg*. The Supreme

2. Criticisms of Securities Industry Arbitration

Employee advocates argue that securities industry employers possess an unfair advantage as "repeat players"[53] in the industry arbitral system. Employees typically are only "one-shotters," who are generally not as skilled in negotiating the arbitral process.[54] This inexperience might reveal itself in the employee's choice of arbitrators, for example; repeat players know which arbitrators are likely to find in their favor, or are likely to offer smaller awards, and therefore can make their choices accordingly.[55]

Employee advocates also complain that many securities industry arbitrators are biased in favor of employers because many arbitrators served in management positions within the industry, have long-standing relationships with management parties involved in the disputes, or in some cases, defended the employers in legal actions.[56] A related complaint is that arbitrators are typically not qualified to handle employment disputes,[57] because their industry expertise relates to the resolution of broker-client disputes and corresponding regulations.[58]

Securities industry arbitrators are typically older, male, and white. While white males might heavily populate the securities industry, those employees most likely to bring statutory claims are not white males. Some sectors of the securities industry (trading, for example) are particularly male-dominated "testosterone alleys"[59] with notorious records of harassment.[60]

Court recently passed on the chance to review *Duffield* despite the circuit split. *See Duffield*, 525 U.S. 996.

53. *See* Lisa B. Bingham, *Employment Arbitration: The Repeat Player Effect*, 1 EMPLOYEE RTS. & EMP. POL'Y J. 189, 191 (1997). Other studies and surveys have offered evidence that employers win before arbitrators more often than in front of juries, and that when employees do win, they are usually awarded less in damages. *See* Alleyne, *supra* note 4, at 425–27; Schwartz, *supra* note 4, at 61.

54. *See* Bingham, *supra* note 53, at 195.

55. *See id.* at 192; *see also* EEOC Notice, *supra* note 13.

56. The American Arbitration Association (AAA) recently defended allegations that its arbitration panels are biased in favor of employers because the panels are composed primarily of white, male attorneys who usually represent management in employment disputes. *See* Olson v. Am. Arbitration Ass'n, 876 F. Supp. 850, 851 (N.D. Tex. 1995); *see also* Margaret A. Jacobs, *Woman Claims Arbiters of Bias Are Biased, Too*, WALL ST. J., Sept. 19, 1994, at B1.

57. *See* Alexander v. Gardner-Denver Co., 415 U.S. 36, 57 (1974).

58. A 1992 General Accounting Office study found that 89 percent of NYSE arbitrators were male, 97 percent of arbitrators were white, .09 percent were black, .06 percent were Asian, and about 1 percent were designated as "other." *See* U.S. GEN. ACCOUNTING OFFICE, EMPLOYMENT DISCRIMINATION: HOW REGISTERED REPRESENTATIVES FARE IN DISCRIMINATION DISPUTES 8 (1994). The average age for male arbitrators was 60; the average age for female arbitrators was 49. *See id.*

59. *See* LISA ENDLICH, GOLDMAN SACHS: THE CULTURE OF SUCCESS 191–92 (1999).

60. The experiences of an industry employee, Helen Walters, as reported by the *Wall Street Journal*, represent uncommon, but not unique, industry behavior. Walters, who worked as a secretary, endured threats, obscene insults, and gifts of condoms from her boss. Industry arbitrators dismissed

II. THE ELIMINATION OF MANDATORY ARBITRATION

When the NASD reorganized in 1996, the SEC required the NASD staff, in its consideration of the future of NASD arbitration, to broaden its focus from NASD members to various employee groups and governmental organizations. In response to the SEC's regulatory pressure, the NASD Board of Directors assembled a task force to examine the NASD arbitration forum generally.[61] In January 1996, the task force released its Report on Securities Arbitration Reform (Report).[62] The Report did not address employment arbitration extensively, but it did offer some important recommendations. The task force determined that the NASD employment arbitration system offers advantages in speed and cost over litigation, and adequately protects the crucial civil rights noted in Title VII. However, the task force also recommended several important changes, including expanded education for arbitrators, expanded disclosure, and the development of a document production list for discovery in employment claims. The task force noted that employment arbitration was "rapidly evolving"[63] and that the NASD should closely watch the development of the law in this area. The Report encouraged the NASD to gather opinions from other sources in order to find proper direction.[64]

The NASD responded to the report by seeking out opinions from member firms, NASD Regulation District officials, employee and employer attorneys, members of the Bar of the City of New York Labor and Employment Committee, and NYSE staff members.[65] Then, in 1997, the NASD Regulation formed

---

her subsequent sexual harassment suit. *See* Margaret A. Jacobs, *Men's Club—Riding Crop and Slurs: How Wall Street Dealt With a Sex-Bias Case*, WALL ST. J., June 9, 1994, at A1.

61. The NASD's Arbitration Policy Task Force was composed not only by regulatory officials, but also by prominent employment law practitioners and industry representatives. *See* SECURITIES ARBITRATION REFORM: REPORT OF THE ARBITRATION POLICY TASK FORCE 3–5 (1996) [hereinafter TASK FORCE REPORT].

62. *See* Release No. 34-39,421, *supra* note 46, 62 Fed. Reg. 66,164, 66,165.

63. *Id.* at 66,166 n.19.

64. *See* TASK FORCE REPORT, *supra* note 61, at 122–23.

65. Unsurprisingly, the employers' groups contended that the process was fair as practiced and represented a superior alternative to litigation. Employees' groups believed that the NASD and other self-regulatory organizations should make arbitration voluntary for employment discrimination claims. Some persons meeting with NASD staff suggested that the NASD adopt the "Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising out of the Employment Relationship" (Due Process Protocol), which sets out employee-friendly procedural standards for arbitration. The Due Process Protocol was offered by a task force composed of a variety of organizations involved in employment law, representing employees, member firm general counsels, and employment arbitrators. A task force composed of individuals involved in labor and employment law developed the Due Process Protocol in 1995, after examining due process issues surrounding arbitration and mediation in the employment context. The American Bar Association (ABA) and various dispute resolution organizations have subsequently endorsed the Due Process Protocol. The Task Force included: Christopher A. Barreca, Co-Chair, Partner, Paul, Hastings, Janofsky & Walker, Rep.,

an Advisory Committee (Committee) to offer specific recommendations on employment arbitration.[66] The Committee held a meeting in June 1997, and invited the EEOC, general counsel of member firms, employee groups and civil rights groups, and counsel for employees and employers. The Committee then consulted neutral arbitration experts and discussed its findings with NASD management.[67]

Council of Labor & Employment Section, ABA; Max Zimny, Co-Chair, General Counsel, International Ladies' Garment Workers' Union Rep., Council of Labor & Employment Section, ABA; Arnold Zack, Co-Chair, President, National Academy of Arbitrators; Carl E. VerBeek, Management Co-Chair, Partner, Varnum Riddering Schmidt & Howlett, Arbitration Committee of Labor & Employment Section, ABA; Robert D. Manning, Angoff, Goldman, Manning, Pyle, Wanger & Hiatt, P.C., Union Co-Chair, Arbitration Committee of Labor & Employment Section, ABA; Charles F. Ipavec, Arbitrator, Neutral Co-Chair, Arbitration Committee of Labor & Employment Section, ABA; George H. Friedman, Senior Vice President, AAA; Michael F. Hoellering, General Counsel, AAA; W. Bruce Newman, Rep., Society of Professionals in Dispute Resolution; Wilma Liebman, Special Assistant to the Director, Federal Mediation & Conciliation Service; Joseph Garrison, President, National Employment Lawyers Association; Lewis Maltby, Director, Workplace Rights Project, American Civil Liberties Union. *See* AAA, *Resolving Employment Disputes—A Practical Guide*, May 9, 1995, at 21.

66. The six-person Advisory Committee held a meeting in June of 1997, inviting the EEOC, general counsel of member firms, employees' groups and civil rights groups, and employee and employer counsel. The committee then consulted neutral arbitration experts and discussed their findings with NASD management. *See* Release No. 34-39,421, *supra* note 46, 62 Fed. Reg. 66,164, 66,166.

67. NASD management was not only influenced by these recommendations, but also faced congressional pressure. In February 1997, Representatives Edward J. Markey, Anna G. Eshoo, and Jesse L. Jackson, Jr., wrote to Chairman Levitt of the SEC, joining the EEOC in questioning the authority of the NASD and other SROs to require arbitration of employment discrimination claims. *See id.* at 66,166 n.21 (citing Letter from Representatives Edward J. Markey, Anna G. Eshoo, and Jesse L. Jackson, Jr., to Arthur Levitt, Chairman, SEC (Feb. 3, 1997)). The SEC responded:

> With regard to whether the mandatory arbitration requirement was within the scope of the NASD's authority, the Commission's response stated that sound arguments could be made on both sides of the issue. The Commission acknowledged that the NASD rule requiring registered persons to arbitrate employment disputes was approved by the Commission as being consistent with the Act, and that it would not be unreasonable to conclude that SROs do have the authority to mandate the arbitration of discrimination claims, provided that fair procedures are in place.

Id. (citations omitted) (citing Letter from Chairman Levitt, to Representative Markey (Mar. 17, 1997)). Markey introduced legislation that would give employees the statutory right to have employment discrimination claims heard in court, or if they so agreed after the dispute arose, to have the claims heard in arbitration. *See* Release No. 34-39,421, *supra* note 46, 62 Fed. Reg. 66,164, 66,166. Isaac Hunt, speaking for the Commission, stated that "the decision as to whether to amend the Federal civil rights laws and the Federal Arbitration Act is uniquely an issue for Congress to decide. The Commission supports [the bill] if Congress believes it will enhance the civil rights of securities industry employees." *Hearing, supra* note 3, at 12 (statement of Isaac C. Hunt, Jr., Commissioner, SEC) The bill died in committee, and has been reintroduced each year since. The latest Senate version of the bill, sponsored by Senator Russell Feingold, was introduced on January 19, 1999, and received three co-sponsors by September. The bill never made it out of the Committee on Health, Education, Labor, and Pensions. *See* S. 121, 106th Cong. (1st Sess. 1999) (proposing to amend certain federal civil rights statutes to prevent the involuntary application of arbitration to claims that arise from unlawful employment discrimination based on race, color, religion, sex, national origin, age, or disability, and for other purposes).

The NASD reported that "[a]fter consideration of all the views presented, and in light of the public perception that civil rights claims may present important legal issues better dealt with in a judicial setting, the NASD determined that the appropriate action was to remove the arbitration requirement for such claims."[68] In August 1997, recommendations were made to the NASD and the NASD Regulation Boards (Boards).[69] The Boards voted to amend the NASD's rules to exclude from the mandatory arbitration requirement all employment discrimination and sexual harassment claims made under federal or state statutes.[70] The rule change was to take effect one year after approval by the SEC, giving the NASD time to enhance the arbitration forum "so that employees will have confidence that there are adequate procedures and safeguards of their rights in NASD arbitration."[71] The one-year period was also designed to "permit employees and firms to determine what agreements they might wish to reach with regard to dispute resolution."[72]

The Boards decided that although "associated persons are no longer required, solely by virtue of their association or their registration with the NASD, to arbitrate claims of statutory employment discrimination[, a]ssociated persons still will be required to arbitrate other employment-related claims, as well as any business-related claims involving investors or other persons."[73] The Boards also voted to require that any arbitration agreements used by firms select as the arbitration forum either an SRO or another forum meeting certain due process standards, adding that the NASD would work with member firms and employees to define the details of such standards. Finally, the Boards voted to provide better disclosure to registered persons of their rights and of the features of arbitration, so that employees are made aware of any rights or remedies they may be giving up by signing Form U-4.[74]

A. The NASD Rule Changes

In October 1997, the NASD sent a proposed rule change to its Code of Arbitration to the SEC. The rule change advanced two broad goals. First, the NASD hoped the rule change would enhance the dispute resolution process for

68. Release No. 34-39,421, *supra* note 46, 62 Fed. Reg. 66,164, 66,166.
69. *See id.*
70. *See id.*
71. *Id.*
72. *Id.*
73. *Id.*
74. *See id.*

the handling of employment discrimination disputes.[75] Second, the NASD designed the rule change to expand disclosure to employees concerning the arbitration of all disputes.[76]

The NASD rule change permitted employees to choose between entering into private arbitration agreements with their employers, or reserving the right to file a case in federal or state court for statutory discrimination claims.[77] However, NASD-registered employees were still required to arbitrate all other types of claims, including claims arising under the Family and Medical Leave Act, the Employee Retirement Income Security Act (ERISA), and all common law claims (for example, wrongful termination, intentional infliction of emotional distress, defamation, negligent supervision, invasion of privacy, and tortious interference with economic opportunity) that are often joined with statutory claims of employment discrimination.

In addition, an NASD-registered employee cannot file a statutory discrimination claim in court if she is obligated to arbitrate pursuant to a separate agreement entered into either before or after the dispute arose. Depending on the employer's policy, then, the NASD rule change offers employees no real protection should employers decide to require mandatory arbitration through their own mandatory arbitration agreements, instead of relying on NASD regulations, as many had in the past.[78]

B. Response to the Rule Changes

The SEC was eager to approve the rule change, and SEC Chairman Arthur Levitt commented that "this rule is a big step in a positive direction."[79] The Commission carefully noted, however, that its approval of the NASD rule change "does not indicate that the Commission necessarily considers arbitration to be an inappropriate forum for resolving discrimination

75. *See id.*
76. *See id.*
77. *See id.*
78. Employers sometimes create in-house arbitration systems, or use outside, independent arbitrators. Some in-house arbitration systems, such as Merrill Lynch's system, are quite elaborate. However, some employees enjoy somewhat of a free market system for arbitration, because they may seek to arbitrate through the NASD, an independent arbitrator, or their own company's system. Because of this "competition" for claims, companies are now working harder to improve their arbitration framework in order to make it more attractive to employees.
79. Press Release, SEC Approves Proposal by the NASD Which Eliminates Requirement that Employees Must Arbitrate Statutory Discrimination Claims (June 23, 1998), *available at* http://www.sec.gov/news/press/98-61.txt.

claims fairly."[80] However, in the unique area of employment discrimination, the Commission believes that the NASD and other SROs should not require arbitration.[81]

The Commission also addressed the concern that member firms would attempt to skirt the NASD rule by requiring their employees to agree to mandatory arbitration through an agreement separate from Form U-4. After the rule change, one member firm stated that it would not require employees to sign such an agreement, and the Commission expected other employers to follow. The Commission also expected to join with the NASD and other SROs in monitoring changes in the use of separate employment contracts by industry firms.[82]

1. Solicited Comments

The NASD rule change could not satisfy all involved, and various groups expressed their disapproval at the rule's shortcomings. One of the commenters, Jeffrey L. Liddle, opposed the rule change because he did not believe that the rule went far enough.[83] Liddle argued that the SEC should prohibit arbitration of all employment claims.[84] Liddle viewed the NASD decision to exclude certain statutory employment claims from mandatory arbitration as an admission of the failure of the NASD arbitral system in dealing with these types of claims.[85]

80. *Id.*

81. *See id.*

82. *See* Release No. 34-39,421, *supra* note 46, 62 Fed. Reg. 66,164, 66,166.

83. *See* Self-Regulatory Orgs., Exchange Act Release No. 34-40,109, *available at* 1998 SEC LEXIS 1223, at *16 (citing Letter from Jeffrey L. Liddle, to Jonathan G. Katz, Secretary, SEC (Jan. 2, 1998) (on file with the SEC)).

84. *See id.*

85. Jeffrey Liddle argued that the NASD's recent changes suggest that the SRO views its own arbitration process as "fundamentally unfair," and unable to afford a claimant with "a full and fair opportunity to vindicate his or her rights." *Id.* at *16 n.33. Liddle was joined by New York Attorney General Dennis C. Vacco in asserting that the proposal should include not only statutory employment claims, but all common law employment claims, including wrongful termination, defamation, negligent supervision, invasion of privacy, tortious interference with economic opportunity, and intentional infliction of emotional distress. *See id.* at *17 (citing Letter from Dennis C. Vacco, N.Y. Attorney General, to Jonathan G. Katz, Secretary, SEC (Dec. 17, 1997) (on file with the SEC)). Helen Norton, director of Equal Opportunity Programs for the Women's Legal Defense Fund, stated that the proposal should include *all* statutory employment rights, such as those under the Employee Retirement Income Security Act and the Family and Medical Leave Act. *See id.* at *17 n.34 (citing Letter from Helen Norton, Director of Equal Opportunity Programs, Women's Legal Defense Fund, to Jonathan G. Katz (Jan. 17, 1998) (on file with the SEC)).

An unlikely pair of commenters opposed the rule change because of the potential bifurcation of claims resulting from the ability of employees or employers to choose the courts in statutory discrimination actions. On the one hand, W. Hardy Callcott, vice president and deputy general counsel of Charles Schwab, warned that the bifurcation of claims would be too inefficient for employers and employees.[86] Schwab, like most employers, prefers to see all claims handled through cost-effective, predictable arbitration. On the other hand, Jeffrey Liddle opposed the rule change because he believed that the courts should handle all employment claims, including common law claims.[87]

The commenters noted that by allowing the litigation of statutory discrimination claims, while forcing all other claims to arbitration, many claims based on the same alleged facts would be inefficiently adjudicated in separate venues. The bifurcation of claims could impose a heavy financial burden on employees and firms.[88] Bifurcation could also result in a slower resolution of claims and create disputes over scheduling and discovery.[89]

Schwab expressed concern that employees might file pretextual statutory discrimination claims in order to access more liberal discovery from the courts.[90] In addition, Schwab noted that the orders resulting from the separate proceedings might conflict with one another.[91] Finally, another rub of the bifurcation issue was that there might be possible res judicata and collateral estoppel effects of the arbitration on the statutory discrimination claims and issues brought before the court.[92]

---

86. *See id.* at *18 n.40 (citing Letter from W. Hardy Callcott, Vice President and Deputy General Counsel, Charles Schwab, to Jonathan G. Katz (Jan. 6, 1997) (on file with the SEC)).

87. *See id.* at *18.

88. *See id.* Schwab noted that "the court case and arbitration case might occur in different states, requiring different lawyers and further increasing the costs of final resolution." *Id.*

89. *See id.*

90. *See id.* at *18 n.40.

91. In his letter,

> Schwab argued that, because it is more likely that arbitrations and investigations will now occur at the same time because the arbitration necessarily will not resolve the discrimination claims, the proposal creates the potential for conflict between investigations by the EEOC or comparable state or local agencies, and arbitrations. Schwab also maintained that parties to arbitration would then subpoena the investigatory files and submit the information to the arbitration panels, who are likely to misunderstand the information in those files, which may be gathered without due process or significant input from the parties involved. Schwab suggested that EEOC and comparable state investigative files should not be subject to discovery or be admissible as evidence in arbitration.

Id.

92. *See id.* at *18.

C. The NYSE Follows

1. The NYSE Proposal Letter

A year after the NASD proposal, the NYSE, "following Chairman Levitt's suggestion,"[93] submitted a mandatory arbitration exception to the SEC. As with the NASD rule change, NYSE-registered employees must arbitrate Family and Medical Leave Act, ERISA, and all common law claims. However, the NYSE proposal differs from the NASD proposal in one important respect. The NASD requires registered employees to arbitrate statutory discrimination claims if they have so agreed either before or after the dispute arose; the NYSE goes further than the NASD "by proposing rule amendments under which statutory discrimination claims will not be eligible for arbitration pursuant to any predispute agreement to arbitrate."[94]

The NYSE rule change added these several provisions to the NYSE rules: The NYSE restated that arbitration remains the default dispute resolution method for any controversy arising out of the employment, or termination of employment, of a registered representative; however, if the claim alleges employment discrimination (including any sexual harassment claim) in violation of a statute, employees or employers may opt for conventional litigation of the dispute. Arbitration is available only if the parties have agreed to arbitrate the claim after it has arisen.[95]

D. Concerns with Both Models

While the rule changes represent an important step by the securities industry toward the creation of a fair arbitral system, the rule changes did not resolve some of the more egregious problems with securities industry arbitration. Although employees now had the option of arbitrating statutory discrimination claims, fundamental flaws in the arbitral framework of both the NASD and NYSE remained, so that the industry would probably lose all employment discrimination claims to the courts.

When the NYSE and the NASD proposed the rule changes, neither offered any plan to address problems of arbitrator qualifications, although

93. Self-Regulatory Orgs., Exchange Act Release No. 34-40,479, 1998 SEC LEXIS 2054, at *8 (Sept. 24, 1998) [hereinafter NYSE Proposal Letter].

94. *Id.*

95. *See* NYSE Rule 347, *reprinted in* 2 N.Y.S.E. Guide (CCH) 3599-3 (1984).

the NASD recognized the need and had plans in the works. In addition, neither had resolved the problem of the bifurcation of claims. In its rule change proposal letter to the SEC, the NYSE mentioned the bifurcation problem in circumstances in which "employment disputes . . . contain both contract or tort claims as well as statutory employment discrimination claims."[96] The NYSE noted that because NYSE Rule 347 required arbitration of claims "'at the instance'" of either party, and therefore may be waived, the entire case may be heard in court if the parties so agree.[97] However, the NYSE stated that "employees in many instances believe that arbitration is preferable to protracted and expensive litigation," and will willingly choose to have their claims arbitrated.[98] This assertion was unrealistic, as the NASD efforts to alter its own arbitral forum showed. Instead, "when a petition to compel arbitration is filed, it is always the *employer* who is seeking to compel arbitration, while the employee is inevitably attempting to bring his or her claims in Federal or in State court."[99] Clearly, securities industry arbitration was not in a position to compete with the courts for discrimination claims.

III. THE MARKET FOR CLAIMS

This part introduces a basic market theory, regulatory competition, and then focuses on a refinement of this theory, regulatory co-opetition, as well as its application to the securities industry employment discrimination claims market.

As Cass Sunstein notes, "We are in the midst of a period of mounting enthusiasm for free markets,"[100] and, naturally, for market analysis. The idea of "law as a product" in a market, as developed by Roberta Romano and others, has served as a useful tool in the analysis of state corporate and securities laws, environmental regulation, antitrust, banking, and product safety.[101] The paradigm legal product analysis examines the ways in which different states engage in "regulatory competition" for corporate dollars by creating attractive regulatory schemes for businesses. At a basic level, the analysis of different

96. NYSE Proposal Letter, *supra* note 93, 1998 SEC LEXIS 2054, at *13.
97. *Id.*
98. *Id.* at *13–*14.
99. *Hearing*, *supra* note 3, at 80 (statement of Cliff Palefsky (citing Schwartz, *supra* note 4, at 122–23)); *see also* Stuart H. Bompey & Michael P. Pappas, *Is There a Better Way? Compulsory Arbitration of Employment Discrimination Claims After* Gilmer, 19 EMPLOYEE REL. L.J. 196 (1993–1994).
100. CASS R. SUNSTEIN, FREE MARKETS AND SOCIAL JUSTICE 3 (1997).
101. *See* Esty & Geradin, *supra* note 2, at 236 n.4.

regulatory schemes provides market participants with information on the relative merits of various approaches, and it allows policymakers to restructure their jurisdiction's regulatory scheme to maximize its appeal.

Some detractors of the regulatory competition model argue that the model fails to describe complex, multifaceted markets.[102] First, the prevailing regulatory competition theory fails to note that cooperation among jurisdictions is often essential to market efficiency. In addition, the horizontal competitive mechanism (for example, competition among states or among securities firms) often does not exert real competitive pressure on inefficient market performers.

Turning to the specific challenges of the securities industry employment claims market, this Comment argues that, just as states compete with one another to attract firms by designing attractive regulatory regimes, an open claims market will force arbitral systems to compete among themselves for employment disputes. Member firms will compete horizontally with one another, and with the exchanges' arbitration systems, in an effort to save on external arbitration expenses, to retain employees, and to avoid negative publicity. However, the employment claims market differs from the interstate market because it involves both governmental and nongovernmental actors—arbitration competes vertically with the courts. The courts, as a branch of the government, exercise authority over arbitral systems as required, or as they are able to, within the existing legal framework. Nevertheless, our legal framework allows arbitral systems to compete with the courts for many types of cases—even those dealing with the enforcement of federal discrimination statutes. However, in an unusual twist on the standard model of competition, governmental agencies, as well as the courts, have an interest in the *success* of their market "competitors." Also, SROs, like the NASD and the NYSE, have an interest in promoting fair arbitration programs among securities firms, if only to reduce the amount of effort the SROs themselves must dedicate to dispute resolution. Thus, the market features cooperation between governmental actors and nongovernmental actors, SROs and industry firms.

This combination of traditional competition and "cooperative" competition requires a more nuanced model for analysis and evaluation. As an alternative to the regulatory competition model, Dan Esty and Damien Geradin developed the "regulatory co-opetition" model. The regulatory co-opetition model, like the regulatory competition model, focuses primarily on governmental actors. Unlike regulatory competition theory, however, which

102. *See id.* at 237.

investigates competition between horizontally arrayed governmental competitors, the regulatory co-opetition model frames three dynamic relationships: (1) intergovernmental (competition among governments, both horizontally and vertically arrayed), (2) intragovernmental (the give and take among governmental departments and officials), and (3) extragovernmental (competition and cooperation among governmental and nongovernmental market participants).[103] The regulatory co-opetition model thus provides the analytic tools to investigate these relationships, which in turn affords a better understanding of competitive arbitration policies, potential market failures, and the role of governmental regulation.

A. A Securities Industry Regulatory Co-Opetition Model

As this Comment applies this more nuanced model to the complex securities industry employment claims market, I must note a few slight adjustments. First, the primary market participants are not governmental entities but rather the securities firms and self-regulatory organizations. The courts typically want to unload, rather than attract, employment disputes. Consequently, the courts generally will take on only the most problematic cases, such as class action litigation. My categories, then, cover dispute resolution fora, rather than governmental units. The three dynamic relationships described by Esty and Geradin survive in slightly modified forms: (1) interforum (competition among securities firms, and between firm arbitral fora and SRO fora), (2) intraforum (give and take between securities firm departments, for example, the give and take between the human resources and the legal departments), and (3) extraforum (competition between industry arbitration and the courts).

1. Interforum Competition: Attracting Claims Among Industry Competitors

When claimants have their choice of arbitral systems, these systems will need to reinvent themselves to respond to the client-claimant's needs. When arbitration systems are not required to compete, they are not likely to require as much from their arbitrators in training, adherence to the law, and reasoning of opinions. Also, arbitration systems in competition with one another will

103. *See id.* at 238.

be more likely to operate at optimal levels of efficiency for the handling of claims, will offer "competitive" settlements, and will likely become more transparent in their functioning. However, employees may nevertheless choose to accept protracted and expensive litigation over an arbitral system that does not offer them vindication of their rights to the extent that the courts could. The natural advantages of arbitration over litigation in speed and cost will not always be enough to offset the courts' advantages in predictability, the chance to appeal, broad discovery, the right to a jury trial, the award size, and the satisfaction of a public victory. Arbitral systems must be more competitive to attract client-claimants. The market will force competitors, who fail to address these concerns, "out-of-business" in the areas in which they are slow to compete.[104]

From an economist's (and employee's) perspective, mobility is an essential factor in the success of the claims market. Employees must be able to forum-shop, at least among a few horizontal competitors. The lack of an efficient horizontal competitive structure exposes the inadequacies of the basic two-player competitive structure (one arbitration forum and the court system). The cost, length, and adversarial nature of litigation might force employees to accept a dehumanizing, unsatisfactory arbitration settlement. On the other hand, an employee may choose to suffer through several years of litigation to achieve a costly public finding of employer wrongdoing. These options do not represent true market choice, but catch-22 forced consumption. Genuine competition between securities firms, and between firms and SROs, will increase an employee's chances of finding a fair bargain.

The competition among firms and between firms and SROs is very different. The competition between firms occurs *before* the claim arises. The firms are not competing for claims (because a PaineWebber employee cannot elect to use Merrill Lynch's arbitration system) as much as they are competing for employees and for good will.[105] Competition between firms and SROs occurs *after* the claim arises. Securities firms have an interest in keeping arbitration

104. Historically, discrimination claims constitute less than 2 percent of all claims filed at the NYSE, *see* NYSE, NYSE Information Memo 99-3 (Jan. 11, 1999), 1999 NYSE Info. Memo LEXIS 1, so the NYSE is likely not concerned about losing this small piece of their arbitration business.

105. However, an insidious potential side effect of the market for claims is that employers may seek to hire employees who are less likely to bring discrimination claims—white males. This concern is mitigated by the operation of the third relationship of my revised regulatory model, the vertical competition/cooperation dynamic. *See infra* Part III.A.3. Continued regulation by the EEOC and the SEC is essential to ensure a fair market. The fair market for claims begins with fair employment practices, as regulated by these agencies.

in-house, or through arbitration providers with whom the firms have negotiated specific provisions and prices. The market functions efficiently only if there exists both vertical mobility (the ability to take some or all claims to court) and horizontal mobility (the ability to take some or all claims to another arbitral system).

2. Intraforum Competition: Departments Within the Firm

The various departments of a securities firm might share a common objective (for instance to become the "best bank" or the most client-oriented brokerage house), but might differ in their means of contributing to that goal. Notably, most, if not all, securities industry firms have nondiscrimination policies and minority hiring plans that are overseen by the human resources department. The legal department will support these policies according to business instructions and state and federal regulations. However, the two departments might seek different objectives once a claim has arisen. The human resources department could be concerned with employee retention, while the legal department wants to bury the claim as quickly as possible through whatever means available. The efforts of the minority recruiting director, for example, might be undermined by the efforts of a legal department that has a reputation for strong-arming discrimination claimants into unfair settlements. Corporate directors might unwittingly exacerbate this problem by creating incentive packages that promote competing agendas—a bonus for success in recruiting minority candidates, and one for avoiding litigation and settlement costs.

3. Extraforum Competition: The Courts and Arbitration Systems

Arbitration systems should not only be attractive relative to one another, but also relative to the courts. A competitive vertical market for claims forces primary market participants "to abandon the manipulation of regulatory mechanisms for private gain ('capture')," [106] and to adopt decisions better in line with claimant preferences. Before the SROs abandoned mandatory arbitration of employment discrimination claims, the courts (or the threat of the courts) could exercise no market pressure on market actors. With this barrier removed, the arbitral systems presumably will change policies to attract claims, to the extent that their legal product is inferior to the courts.

106. Esty & Geradin, *supra* note 2, at 239.

Of course, arbitration organizations and the courts compete against each other for different reasons. Courts "compete" for claims only to the extent that they are required to by law. The federal courts are unwilling participants in the claims marketplace. They do not actively seek out cases, but take those cases that they must adjudicate by law. The duty of the court to respond to particular questions, to rule on a point of law, engages the courts in the market for claims.

The arbitration forum, on the other hand, must be a more active participant in the market. Arbitral systems are created by self-regulatory organizations, such as the NYSE and the NASD, by member firms within those organizations, or by wholly independent organizations such as the American Arbitration Association (AAA), who then sell their arbitral product to member firms and their employees. In the ideal market for claims, all of these arbitral systems must compete with the courts for claims, and so must make their product at least as attractive (or competitive) as that of the courts.[107] In employment discrimination claims, at least, the lack of competition between the courts and the arbitral systems has allowed the arbitral systems to operate inefficiently, with a group of market participants using market inequalities and the lack of product choice to gouge other participants. The arbitration forum already enjoys many advantages over the courts, but also lags behind the courts in many important areas. The securities industry employment discrimination claims market, particularly, has not functioned efficiently for claimants.

Gains in efficiency will come from the arbitral fora rather than the courts. Courts are not likely to change their product, or if they do, will probably respond slowly to changes in the marketplace. The court system, like a large, bureaucracy-laden corporation, offers its client-claimants a name brand and a predictable service. The courts also offer the possibility of a large return for an employee's extra investment of time and effort—the large damage award. Arbitration must obviously outperform the courts in order to lure claimants away. Because of the position of the courts as a government entity and reluctant competitor, the relationship between the courts and the arbitral system is *co-opetitive*, rather than purely competitive. The courts cooperate with the arbitral systems by encouraging or enforcing basic standards that the arbitral systems must meet. Some of these basic standards might include adherence

107. The arbitral products must be at least as attractive to employees as litigation, but beauty is in the eye of the consumer: Attractiveness does not imply similarity. Indeed, real choice in the marketplace depends on the procedural differences between litigation, arbitration, and other forms of dispute resolution.

to the applicable law in deciding claims, reasoned written opinions, and some training in the subject matter before them. If the arbitration systems are not meeting these goals, the courts might rely on the enforcement strength of the government's employment regulatory authority, the EEOC. The ability of these regulatory bodies to enforce a competitive market could be enhanced through passage of a bill like the Civil Rights Procedures Protection Act.[108] The Civil Rights Procedures Protection Act was initiated as a response to due process concerns, and would "amend certain Federal civil rights statutes to prevent the involuntary application of arbitration to claims that arise from unlawful employment discrimination based on race, color, religion, sex, national origin, age, or disability, and for other purposes."[109] Thus, the act would instantly create a more efficient market for discrimination claims by forcing firms to compete with the courts and with other arbitral fora.[110]

Finally, the market itself will act as a deterrent. In an open market for claims, firms that do not meet basic standards will lose claims to the courts,[111] or to each other.

IV. THE NASD REVISION: A COMPETITIVE RESPONSE

This part moves from theoretical description to practical analysis of arbitration in the new market for employment discrimination claims. The best indications that arbitration will improve, within the market framework described herein, come from a series of rapid changes in securities industry arbitration since the elimination of the mandatory arbitration of employment discrimination claims.

A. The NASD Arbitration Improvements

As noted in Part III, regulatory pressures from the SEC persuaded the NASD to reevaluate its arbitration format, resulting in the elimination of

108. The last time Congress tried to pass the Civil Rights Procedure Protection Act, the bill died in committee. *See* H.R. 872, 106th Cong. (1999); S. 121, 106th Cong. (1999).

109. *Id.*

110. The act would also respond to complaints from employee rights organizations that claim the SEC should not handle the administration of concerns surrounding the adjudication of employee discrimination claims. *See Hearing*, *supra* note 3 (statement of Cliff Palefsky. The SEC or the industry self-regulatory bodies would presumably limit or cease employment discrimination policymaking, and would leave discrimination policing activities to the EEOC and the courts.

111. The effect of the horizontal competition between the courts and the arbitral systems prevents the race to the bottom, in which complete deregulation of standards creates unattractive market outcomes. *See* Esty & Geradin, *supra* note 2, at 237.

mandatory arbitration. The industry and practitioner comments received as part of the SEC's rule approval process put the NASD on notice of the many potential obstacles facing arbitration in a competitive forum market. The NASD understood that allowing the employees to choose between arbitration and the courts would drastically decrease the number of claims heard by industry arbitrators; employees choosing to litigate claims would result in increased costs for the firms that the NASD represents.[112] In response to these competitive pressures, the NASD Regulation staff assembled a working group composed of attorneys for employees, the general counsel, and industry arbitrators with employment law expertise to advise the NASD on employment arbitration matters, and to create a more efficient and competitive arbitral system. The working group met on a number of occasions in 1997 and 1998, and it assisted the NASD Regulation staff in preparing recommendations to the NASD Board of Directors.

In October 1998, the NASD submitted an amendment to the NASD Code of Arbitration approved by the SEC earlier that year. The amended rules represent the best efforts to date of an industry-led solution to the major complaints with employment arbitration. The proposal sets out a number of new provisions, based in large part on an earlier effort "to examine questions of due process arising out of the use of mediation and arbitration for resolving employment disputes": the "Due Process Protocol" (Protocol).[113] The Protocol recommendations have been adopted by several dispute resolution fora,[114] and the NASD decided to follow the due process procedures recommended in the Protocol.

After consideration of the Protocol, the working group and the NASD Regulation staff made recommendations to the Boards. The Boards adopted the recommendations in October 1998, and the NASD proposed the amendments to the SEC. The SEC approved the changes in November, 1999. The later (and more competitive) rule changes cover the qualifications of arbitrators, the number of arbitrators hearing claims, and revised rules for discovery,

112. Just as the NASD's initial move to eliminate mandatory arbitration should be taken as a response to regulatory pressures by the SEC and the threat of legislation, rather than as an internal impulse for reform, the NASD's later changes should be viewed as an effort to maintain arbitration as a viable alternative to litigation, rather than as an expression of a new-found sympathy for employees. Obviously, were it not for regulatory pressures to eliminate mandatory arbitration, which resulted in arbitration's exposure to a competitive market, the NASD would have little incentive to improve arbitration for employees.

113. AAA, *supra* note 65, at 16.

114. Two major arbitration providers, the AAA and JAMS/Endispute, have agreed to follow the recommendations of the protocol.

awards, and attorney's fees. These rules, which I briefly describe, also offer a solution to the problem of bifurcation of claims, and offer new guidelines for the disclosure of the effects of arbitration clauses.

1. Amendments to the NASD Code of Arbitration

a. Arbitrator Qualifications

The NASD addressed one of the most important shortcomings of securities industry employment discrimination by setting out stricter qualifications for arbitrators who hear employment discrimination claims. The NASD based its guidelines on the general recommendations of the Protocol. The Protocol provided that "arbitrators selected for such cases should have skill in the conduct of hearings, knowledge of the statutory issues at stake in the dispute, and familiarity with the workplace and employment environment."[115] The NASD Regulation noted that many arbitrators on its roster have experience or training in employment law.[116] Furthermore, the NASD Regulation trains its arbitrators in employment law issues, with the help of experienced employment attorneys. However, the NASD believed that to implement the provisions of the Protocol it needed to create "a more specialized roster of available arbitrators for intra-industry cases in which statutory discrimination is alleged."[117] The NASD may use a specialized roster, or may look to the rosters of other dispute resolution providers.

In order to create a specialized roster, the NASD Regulation proposed that "[o]nly arbitrators classified as public [nonindustry] arbitrators . . . shall be selected to consider disputes involving a claim of employment discrimination, including a sexual harassment claim, in violation of a statute."[118] The definition of "public arbitrator" excludes not only securities industry employees and their immediate family members, but also attorneys, accountants, and other professionals who have devoted 20 percent or more of their professional work in the last two years to clients who are engaged in the securities business.[119]

115. *Id.* at 18; *see also* Self-Regulatory Orgs., Exchange Release Act No. 34-41,461, 1999 SEC LEXIS 1099, at *17 [hereinafter NASD Proposal Letter].

116. *See id.*

117. *Id.*

118. NASD, Code of Arbitration Procedure Rule 10211(a) (proposed), *in* NASD Proposal Letter, *supra* note 115, 1999 SEC LEXIS 1099, at *5–*6.

119. *See* NASD, Code of Arbitration Procedure Rule 10308, *reprinted in* NASD Man. (CCH) 7574 (1997).

For single arbitrators hearing the employment discrimination claim, or for chairpersons of an arbitration panel hearing an employment discrimination claim, the NASD Regulation proposed that the arbitrator must possess the following: a law degree; membership in the Bar; "substantial familiarity with employment law;" and ten or more years of legal experience that included at least five years of law practice, law school teaching, government enforcement of equal employment opportunity statutes, experience as a judge, arbitrator, or mediator, or experience as an equal opportunity enforcement officer or in-house counsel of a corporation. In addition, the single arbitrator or panel chairperson "may not have represented primarily the views of employees or employers within the past five years," with "primarily" meaning 50 percent or more of the arbitrator's business or professional activities.[120]

The NASD Regulation also proposed changes to the composition of panels, so that for cases involving claims of employment discrimination, whether or not other issues are also involved, all arbitrators must be classified as public.[121] Finally, the NASD proposed a higher payment threshold for single arbitrator cases. Under the proposed rules, a single arbitrator will handle claims of $100,000 or less. The higher threshold lowers the cost for the parties (this is, of course, especially relevant for client-claimants, who have found that arbitration is not always as cheap as arbitration supporters contend[122]). Furthermore, the rule change allows for better use of the relatively scarce number of qualified employment arbitrators. For claims seeking more than $100,000, a three-person arbitration panel will decide the case.[123]

b. Awards

The NASD Regulation also looked to the Protocol to redefine its awards guidelines. The Protocol provides:

> The arbitrator should be empowered to award whatever relief would be available in court under the law. The arbitrator should issue an opinion and award setting forth a summary of the issues, including the type(s) of dispute(s), the damages and/or other relief requested and

120. However, note that "Rule 10211(c) provides that parties may agree, after a dispute arises, to waive any of the special qualifications contained in either paragraph (a) or paragraph (b). Such a waiver is not valid if it is contained in a predispute arbitration agreement." NASD Proposal Letter, *supra* note 115, 1999 SEC LEXIS 1099, at *20.

121. *See* NASD, Code of Arbitration Procedure Rule 10212(a), *reprinted in* NASD Man. (CCH) 7546 (1997). Again, however, "parties may agree to a different panel composition in a particular case." NASD Proposal Letter, *supra* note 115, 1999 SEC LEXIS 1099, at *21.

122. *See Hearing*, *supra* note 3, at 79 (statement of Cliff Palefsky).

123. The parties may agree to have the case decided by a single arbitrator. *See* NASD, Code of Arbitration Procedure Rule 10212, *reprinted in* NASD Man. (CCH) 7546 (1997).

> awarded, a statement of any other issues resolved, and a statement regarding the disposition of any statutory claim(s).[124]

The NASD Regulation adopted this wording as an amendment to the Code of Arbitration, making only one language change to the Protocol recommendation. The NASD deleted the word "opinion" in order to avoid confusing parties who might otherwise anticipate a written opinion from the arbitrator, such as they might receive from a judge. The NASD Regulation was comfortable with the omission because parties may request underlying reasons, although arbitrators may grant or deny the request.[125]

c. Coordination of Claims

The NASD Regulation responded to the predictions of bifurcation made by commenters on the first rule change, by proposing adoption of a new rule on joinder of employment discrimination claims that may be filed in court, and those required to be arbitrated under NASD rules. The rule allows parties to resolve all related matters in court, if they so choose. Also, if a claimant files an employment discrimination claim in court, and files related common law claims in arbitration pursuant to a mandatory arbitration agreement, the respondent has the option to combine all claims in court.[126] The NASD included a separate paragraph to clarify that "if an associated person files a claim in court that includes matters that are subject to mandatory arbitration, either by the rules of the NASD or by private agreement, the defending party may move to compel arbitration of the claims that are subject to mandatory arbitration."[127] Thus, there exists a market for employment discrimination

---

124. NASD Proposal Letter, *supra* note 115, 1999 SEC LEXIS 1099, at *26; *accord* AAA, *supra* note 65, at 20. One of the principal competitive advantages of litigation over arbitration is the possibility of a large jury award. While the NASD rule allows an arbitration panel to assess punitive damages, these damages are probably not likely to be as high as a jury might award a claimant. Although the possibility of the large jury award represents a significant advantage for litigation, an efficient arbitration system may yet successfully compete for claims through its advantages of privacy, speed, and possibly cost.

125. This may be a benefit of the court system that client-claimants are willing to forego. Horizontal competitive pressures may force arbitration systems to require reasoned opinions of their arbitrators, but requiring opinions of arbitrators would likely increase the cost and decrease the speed of arbitration.

126. The new NASD rule

> would include a pre-filing procedure in which the claimant may certify to the Director of Arbitration that he or she communicated with the respondent about the possibility of filing all claims in court initially, in order to save the expense of arbitration fees and attorney fees to draft arbitration claim papers. If the respondent does not agree to consolidate all claims in court, and an arbitration claim is then filed, proposed Rule 10216 provides several methods for coordinating claims filed in court and in arbitration.

NASD Proposal Letter, *supra* note 115, 1999 SEC LEXIS 1099, at *31–*32.

127. *Id.* at *37.

claims, but not for other common law claims subject to mandatory arbitration agreements. These claims are still subject to the inefficiencies of a closed arbitration system. Thus, while employment discrimination claimants now enjoy a better product, the common law claims market does not operate under any competitive pressures.[128]

d. Disclosure When Signing Form U-4

The NASD Regulation also proposed adoption of a "model disclosure statement" to be given to registrants signing Form U-4.[129] The disclosure statement helps registrants understand what they are getting into by signing Form U-4, and it both explains that Form U-4 contains a predispute arbitration clause, and tells registrants where the clause is located on the form. The disclosure statement further advises the registrant to read the arbitration agreement. The NASD does not mention any arbitration agreements the registrant may enter into or may have entered into with the member firm. The NASD expects member firms to "either mak[e] proper disclosure to its employees about its private arbitration agreement, or risk[] an adverse decision in later litigation concerning any inadequacy in the disclosure."[130]

The proposed disclosure statement alerts the registrant that she is forfeiting the right to sue in court except as provided by the rules of the arbitration forum. The disclosure agreement then notes an exception to the arbitration requirement for statutory employment discrimination claims.[131] The statement advises employees that the rules of other arbitration forums (the forum of the employees' company, for example) may be different.

e. Discovery

The NASD Regulation also examined the Due Process Protocol guidelines on discovery. The Protocol notes that "[o]ne of the advantages of arbitration is that there is usually less time and money spent in pre-trial discovery," nevertheless, "[a]dequate but limited pre-trial discovery is to be encouraged and employees [and their representatives] should have access to

---

128. Nor is it likely to have any competitive pressure, at least from the courts. Clearly, the case law supports mandatory arbitration of nonstatutory employment law claims, so the only competitive pressure must come from other arbitral systems. *See supra* Part I.B.1.

129. NASD Proposal Letter, *supra* note 115, 1999 SEC LEXIS 1099, at *38.

130. *Id.*

131. This language avoids market inefficiency by including explicit language alerting a registrant of his or her right to sue in employment discrimination cases. If such language were omitted, the registrant might not work under the assumption that he or she may sue if victimized through employment discrimination.

all information reasonably relevant to mediation and/or arbitration of their claims."[132] The NASD approved of the language of the Protocol, but added that employers enjoy the same rights to discovery as employees.[133] The NASD Regulation felt that their current procedures concerning pretrial discovery already met the Protocol criteria, so they did not need to alter their procedures. However, the NASD Regulation proposed changes in their deposition procedures in employment discriminations cases to meet the Protocol standard. The added clause states that "[n]ecessary pre-hearing depositions consistent with the expedited nature of arbitration shall be available."[134] NASD arbitrators are to consider the relevancy of the information sought from the deponent, as well as the time and expense of the deposition in determining whether the deposition is necessary.[135]

f. Attorney's Fees

Another important NASD Code of Arbitration change comes from the Protocol's guidelines on attorney's fees.[136] The amended code gives the arbitrator the "authority to provide for reasonable attorneys' fee reimbursement, in whole or in part, as part of the remedy in accordance with applicable law."[137] The attorney's fee amendment raises the NASD arbitration system to the standard set by the courts. Thus, this amendment creates a much more attractive product for lower-paid employment discrimination claimants.

---

132. *See* AAA, *supra* note 65, at 18.

133. The NASD notes that

> there also could be situations in which the employee has documents that the employer requires to prepare its case, such as records of the employee's outside business activities or prior employment. Therefore, the NASD Regulation believes the term "employees" in the quoted provision should be interpreted to include all parties to the employment dispute.

NASD Proposal Letter, *supra* note 115, 1999 SEC LEXIS 1099, at *22–*23.

134. NASD, Code of Arbitration Procedure Rule 10213(a), *reprinted in* NASD Man. (CCH) 7546 (1997).

135. *See* NASD Proposal Letter, *supra* note 115, 1999 SEC LEXIS 1099, at *23. "Such considerations are already provided for in Rule 10321, paragraphs (d) and (e), which set forth procedures for deciding unresolved issues either at the pre-hearing conference or by appointment of a selected arbitrator." *Id.*

136. The Protocol states that

> The amount and method of payment for representation should be determined between the claimant and the representative. We recommend, however, a number of existing systems which provide employer reimbursement of at least a portion of the employee's attorney fees, especially for lower paid employees. The arbitrator should have the authority to provide for fee reimbursement, in whole or in part, as part of the remedy in accordance with applicable law or in the interests of justice.

AAA, *supra* note 65, at 17.

137. NASD Proposal Letter, *supra* note 115, 1999 SEC LEXIS 1099, at *26.

The change also creates an incentive for attorneys to take arbitration claims on a contingency basis, and to suggest arbitration to their clients.[138]

B. Arbitration System Improvements Among Securities Firms

Recent changes in firm policies also indicate interforum competitive pressure. In response to the open claims market, many NASD and NYSE member firms have developed proprietary mediation and arbitration systems. Member firms have two primary reasons for creating proprietary arbitration systems. First, NASD and NYSE arbitration, while offering a more private forum than cases brought before the courts, do not offer the same level of privacy that member firms might enjoy in their own arbitration systems. When a case goes through NASD arbitration, victorious parties may hold press conferences announcing the decision, although parties may not make public many details surrounding the allegations. However, a member firm may create an arbitral forum in which parties must keep decisions private, as in a settlement agreement.

Many employees victimized through workplace discrimination see the publication of an employer's wrongdoing as an important element of their relief. Therefore, because member firm arbitration competes with NASD and NYSE arbitration, as well as litigation in the courts, member firms who wish to avoid discrimination publicity must make their arbitration systems more competitive by offering incentives to counteract the benefits of publicizing the victory.[139] Firms might do this by reducing the costs associated with bringing a claim through in-house arbitration. The firms might also offer a more timely resolution to the claim than industry arbitration (and, certainly, the courts).

Another potential benefit to proprietary arbitration is the potential decreased cost of this arbitration.[140] Member firms might negotiate a deal with an arbitration provider to offer their services at a discount as compared

138. Generally, employment lawyers have dissuaded clients from pursuing claims in arbitration. *See Hearing*, *supra* note 3 (statement of Cliff Palefsky).

139. A public opinion also must be considered an important element in the pricing of incentives. The publication of the proceedings and the opinion affects not only the individual employee, but other employees who need the information in order to, inter alia, assess their chances in arbitration. *See supra* notes 30–31 and accompanying text.

140. As noted by Patricia Ireland, president of National Organization for Women (NOW):

> Since the only way women and people of color can have their day in court is to form a class and sue, companies—like Smith Barney—face expensive class-action suits in federal court. The plaintiffs in the Smith Barney case never would have initiated a class-action if they could have had access to the courts. Ultimately, even billion-dollar Wall Street companies will benefit when arbitration is an option—not a mandate.

Hearing, *supra* note 3, *available at* 1998 WL 437056 (statement of Patricia Ireland, President, NOW).

to the fees paid by the corporation and its employees to the exchanges' dispute resolution programs. While this decreased cost also represents a competitive incentive to the employee, the arbitral system contracted by the member firm may offer a product inferior to the exchanges' dispute resolution programs; employees may need to investigate the quality of the forum. However, because claimants may not be able to evaluate the benefits of a forum, the EEOC could perform a valuable service by investigating arbitration providers and providing claimants with the information obtained.

The member firm's arbitration provider must achieve a delicate balance between employers' interests and employees' interests. On the one hand, the arbitration provider may be competing with other arbitration providers for the firm's business, so there exists some competitive pressure to skew results in favor of employers rather than employees. On the other hand, the ultimate client remains the employee, who still has the choice of exchange dispute resolution or litigation through the courts. Arbitration providers who sell their services to member firms must find the right balance between these interests in order to retain business.

Merrill Lynch was first among those member firms to follow the NASD in repealing mandatory arbitration (although the move resulted from a settlement in an employment discrimination suit brought by eight women representing a class of 2500 female brokers). Merrill Lynch agreed to handle claims through a new ADR[141] process created with assistance from the Northwestern University School of Law.[142]

---

141. A Merrill Lynch spokesperson stated that

> "This is an innovative program to resolve all legal claims by employees registered and non-registered . . . . We believe the system will reduce the time and cost involved in resolving claims. We believe that we will be a model, not just for the securities industry but for all businesses developing fair workplaces for the 21st century."

Merrill Set to Move on New Dispute Resolution Program, SEC. WEEK, May 18, 1998, at 8 (quoting a Merrill Lynch spokesperson). According to industry watchers,

> the new program is another way to keep employees from going to court when they have a dispute and maintaining arbitration on such issues in its present form as much as possible. "[Merrill Lynch] is trying to keep from going to court as much as possible," one source indicated. "It may cost more, but it could save money in the long-run. The goal is to choose the new arbitration over court." The source also surmised that since Merrill Lynch was paying for the outside arbitration, that was the path it wanted take instead of industry arbitration. Jeffrey Liddle of Liddle & Robinson, called the new program a sham. "The whole thing is just a far more coercive substitute for the current mandatory arbitration system," said Liddle, a well known expert in the area. "It's not done with any good intentions. The motivation behind this is not pure."

Id. Merrill Lynch's intentions are unimportant, however, so long as the market operates efficiently. If employees believe that Merrill Lynch's product is a fair bargain for the waiver of certain rights, who can stop them from contracting as they see fit?

142. *See* Darryl Van Duch, *Merrill Deal Paves Way for New ADR*, NAT'L L.J., MAY 18, 1998, at B1.

Merrill Lynch's dispute resolution process begins with a one-day mediation session, paid for by the firm. If the mediation session does not produce a resolution to the conflict, the employee may file a claim in court, may go to an Exchange arbitration system (NYSE or NASD), or may use an independent arbitrator such as the AAA or JAMS/Endispute. Merrill Lynch helps persuade employees to use the AAA forum or JAMS/Endispute by offering to pay all fees for the fora, excepting fees for the claimant's counsel.

Tellingly, PaineWebber followed Merrill Lynch's lead later in 1998.[143] Under PaineWebber's revised dispute resolution program, employees may attempt to settle claims through mediation (arranged and paid for by PaineWebber), use arbitration, or take the claims to the courts.

Merrill Lynch and PaineWebber's actions indicate a pattern of forum competition among firms. We also notice that their arbitration procedure changes indicate a "race to the top" in terms of procedural protections for industry employees. Still, we have not yet arrived at the end of the race.

V. REMAINING CONCERNS: MARKET FAILURES AND MARKET PROTECTIONS

Unfortunately, Merrill Lynch and PaineWebber employees are the only industry employees to date who enjoy an open market for employment discrimination claims. However, the fact that at least two major employers have already chosen to move away from mandatory arbitration may create public pressure for other firms—the market for claims may correlate with the market for employees, investors, and customers. Other firms might risk losing some competitive advantage to Merrill Lynch or PaineWebber. On the other hand, several market failures work against the development of the claims market. These market failures must be overcome in order to bring about a fair and open market across the entire securities industry. My consideration of these market concerns moves from the fundamental question—

---

143. *See PaineWebber Offers Workers Choices in Dispute Resolution*, LEGAL INTELLIGENCER, Dec. 7, 1998, at 4.

> New York PaineWebber Group Inc. will offer employees a list of choices for resolving discrimination and harassment disputes, another move toward dismantling U.S. securities firms' industry-sponsored arbitration process.
>
> . . . PaineWebber's plan, which begins Jan. 1, [1999,] lets employees attempt to settle claims with local managers and human resources departments. Independent mediation, arranged and paid for by the firm, and arbitration and the courts are now options at the discretion of the employee. The program "will greatly benefit our employees by providing easily accessible, flexible and constructive means for resolving disputes," said Gus Carlson, a company spokesman.

Id.

the appropriateness of a market response to discrimination—to the more specific questions regarding potential market failures.

A. The Appropriateness of a Market Response

Is a market for claims an adequate and appropriate mechanism for resolving employment disputes and conquering the discrimination at the root of the dispute? Presumably, an inability to provide an adequate product in the claims market will adversely affect a company's ability to attract and retain employees—thus, there is a correlation between the claims market and the labor market. Ordinary market wisdom assumes that employers who discriminate will suffer a competitive disadvantage because they must draw from a smaller employee pool. However, several persuasive arguments and observations suggest that market forces do not always stop discrimination, and in fact may even perpetuate and contribute to discrimination.

First, third parties (clients, for example) might contribute to or indirectly create discriminatory policies.[144] Suppose, for example, that the majority of a company's customers discriminate, and do not like dealing with black employees, women employees, or others. This company maintains a competitive edge through discrimination, even if it does not recruit valuable minority candidates.

Another type of discrimination occurs not because of irrational animus, but because of statistical differences between groups.[145] For example, a company may avoid hiring women because it possesses persuasive data showing that women are more likely, on average, to leave a high-pressure job than are men. Alternatively, a company may surreptitiously avoid hiring a handicapped employee because it hopes to avoid capital expenditures required to make business facilities accessible to the employee.

Finally, to the extent that discrimination already exists in an industry, the market environment might already include discriminatory programs and patterns. Thus, the cost in human capital required to enter and succeed in the market may be too high for new market participants—those who have historically suffered discrimination.[146] As efforts to enter a profession repeatedly fail, potential market players will shy away from the profession, resulting in an ever-decreasing number of minority applicants.[147]

144. *See* SUNSTEIN, *supra* note 100, at 153.

145. *See id.* at 155.

146. *See id.* at 156–57.

147. Professor Cass Sunstein notes, however, that "this picture is too bleak in many settings." *Id.* at 158. The "extraordinary persistence" of minority efforts to enter traditionally white, male professions "is one of the most striking phenomena of the post–World War II period." *Id.* Indeed, some people respond to discrimination by increasing their efforts to break into a profession. *See id.*

These arguments underscore the primary reason to prefer a regulatory co-opetition model over a regulatory competition model for the resolution of employment discrimination claims: A market without vertical competition, which includes some regulatory pressure, probably could not supply a fair discrimination claim dispute resolution. On the other hand, a regulatory, co-opetitive market will be able to respond to concerns that other market paradigms cannot. Rather than relying on market forces to break up market barriers, as does the regulatory competition model, the regulatory co-opetition model depends on governmental agency supervision, primarily through the efforts of the EEOC, and to a lesser extent, the SEC, who are in turn empowered by appropriate legislative reform. The regulatory co-opetition model also relies on vertical competitive pressures from the court systems. The threat of litigation, with the possibility of large awards and negative publicity, can have a serious influence on the arbitration procedures of industry firms.[148]

Having considered the appropriateness of an employment discrimination claims market, we now shift our focus to the specific market failures that impede the market's efficient operation.

B. The Problem of Imperfect Information

The first market failure to consider is the problem of imperfect information. The problem of imperfect information actually concerns two separate issues: the problem of imperfect predispute information, and the problem of imperfect postdispute information, which I shall discuss in turn.

1. Predispute Information

The market delivers inefficient outcomes to the extent that the public and potential employees are not aware of, or have no access to, information about firm policies. Often, employees wooed by reputable firms will not consider the potential for employment disputes, nor even consider the content of the piles of forms their new employer asks them to sign.[149]

148. As information technology shifts industry firms' focus from regional or national to global, and allows customers and investors instant access to detailed corporate news and information, securities firms will doubtlessly do all they can to preserve a good (or at least neutral) public image. However, as I discuss in the next part, we must be careful not to place too much faith on the effects of publicity. *See infra* Part V.B.

149. According to Bales,

> It is not difficult to imagine an employer giving a new employee a stack of ten or fifteen employment documents to sign and only a few minutes to sign them. Nor is it reasonable to assume that, even under the best of circumstances, more than a small percentage of

Furthermore, one might argue that employees, investors, and customers generally do not understand or care about a firm's arbitration policy, especially when the effects of various policies are unclear.

In an unregulated, horizontal market for claims, the lack of information and the lack of interest (until a claim arises) combine to produce an inefficient market outcome. The first answer to the problem of imperfect information is simply more information, or more accurate information. Thus, the general and industry media may alleviate the problem of imperfect information as discrimination suits against large firms (especially class action suits) make national news and receive in-depth treatment through industry reporters. Talk of the firm's employment and dispute resolution practices occasionally accompanies reports of the cases, and the policy information may trickle down to industry employees, prospective employees, clients, and investors.[150] As the public gains access to correct market information, more efficient (less discriminatory) firms should enjoy some advantage over firms with discriminatory policies and practices.

However, we must be careful not to exaggerate the effect of the awareness of discriminatory policies on employee choice. Professor Sarah Rudolph Cole argues that

> the publicity surrounding employment disputes typically focuses on the dispute and how it is resolved by judge and jury. Publicity about the use of arbitration to resolve employment disputes and the consequent effects arbitration has on the resolution of discrimination claims is quite limited. Thus, the numerous newspaper articles about statutory discrimination claims are unlikely to have a perceptible effect on an employee's risk assessment.[151]

Even when employees have some basic policy information, they might inaccurately perceive their risk of suffering from discriminatory behavior in the

---

> employees will read and understand agreements they sign committing them to binding arbitration. Instead, an employee usually signs the agreement with little or no thought of future employment law violations or of what effect the agreement will have on obtaining redress for such a violation.

BALES, *supra* note 21, at 163 (footnotes omitted). The memories of my own employment with a securities firm do not include any recollection of signing a mandatory arbitration clause, although I am sure that I signed one. As Jeffrey Stempel notes, "people want to eat first and consider legal and philosophical implications later." Jeffrey W. Stempel, *A Better Approach to Arbitrability*, 65 TUL. L. REV. 1377, 1387 (1991).

150. Obviously, the media may also contribute to the problem of imperfect information. To the extent that they accurately publicize the policies of industry firms, and employees act on the information, the media represent an important weapon to combat the problem.

151. Cole, *supra* note 4, at 481 (footnotes omitted).

workplace.[152] Inaccurate risk assessment might bring employees to agree to ultimately unsatisfactory contract terms (for example, mandatory arbitration).

The vertical competition dynamic is imperative to the creation and maintenance of a fair claims market. As a market protection, federal regulators (such as the EEOC and the SEC) and federal competitors (the courts) must step in to ensure that adequate information is available to employees, that employment contracts are fair, and that the lawyerspeak of employment contracts is disclosed as intelligible information so that employees will clearly understand their rights and responsibilities. Mandatory disclosure forms, such as those distributed to NASD registrants, are thus an important part of the solution to the problem of incomplete information. However, an employee's first exposure to a firm's arbitration procedures may come after the end of a grueling interview process, when an employee has already given notice to a former employer, or when she has declined further interviews with other firms. At this point, an anxious new employee may note the arbitration clause, pray that she never has to see it again, and sign the forms. The EEOC or the SEC (and perhaps the SROs) might respond by pressing industry employers to provide disclosure statements on dispute resolution policies *before* the employer asks the employee to accept an offer. Regulators might also require that, along with a written explanation of crucial employment and dispute resolution policies, a human resources officer clearly explains the policies to the employee before the employee accepts the offer of employment.

Industry recruiters and school placement officers might also provide valuable protection. These professionals should take care to thoroughly understand the various employment and dispute resolution policies of industry firms. They should also take great care to avoid referring minority candidates to discriminatory firms, and should make nonminority candidates aware of the firm's practices. As Sunstein notes, some firms with third-party discriminatory pressures may benefit by drawing from a nonminority pool. However, this smaller pool may dry up as nonminority applicants, fully informed of the firms' discriminatory practices, choose not to seek employment with those firms.

Above all, recruiters and placement officers must understand a candidate's risk perception. They must carefully manage candidate expectations through the use of more accurate information sources, such as employment data and statistics on arbitration decisions, in order to combat inaccurate risk

152. *See* Paul Slovic et al., *Facts Versus Fears: Understanding Perceived Risk*, *in* JUDGMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES 465 (Daniel Kahneman & Amos Tversky eds., 1982); *see also* Cole, *supra* note 4, at 481.

perceptions developed through false or incomplete information and limited experiences.

2. Postdispute Information

After a dispute has arisen, employees must understand the differences between arbitration and litigation in order to make an informed market choice among dispute resolution options. Again, federal regulators and SROs must play an important role in ensuring that product information reaches claimants. First, the SROs should distribute accurate and complete information on the procedural aspects of industry dispute resolution and conventional litigation. The federal regulatory bodies, the SEC and the EEOC, should ensure that the information provided by an SRO does not create a bias toward arbitration—its slight, natural bias as an industry organization—but should ensure that the benefits and burdens of each system are weighed by the claimant according to her own needs and desires. The EEOC might also continue to offer claimants direct counseling services. Ideally, the EEOC would not promote federal dispute resolution services to the detriment of arbitration—its slight, natural bias as an employee advocate—but would act as a market facilitator.

C. Too Few Competitors in the Marketplace

Another problem that contributes to the inefficiency of the market is that there are simply too few competitors in the marketplace. Industry arbitration has been the only product available in the mandatory arbitration regime. Although there are many competitors in a general sense—that is, many different firms trying to attract the same business and the best people to run that business—the market competitors operated under a de facto monopoly. Employees could bring claims before NASD or NYSE panels, but they could not bring claims to court or to nonindustry arbitration. So, while there was a degree (perhaps an insignificant degree) of horizontal competition among the industry arbitral fora, there was no vertical competition—competition between the courts, industry arbitration, and the nonindustry arbitration systems of the member firms. After the introduction of vertical competition, market pressures should compel industry arbitration providers to introduce viable alternative legal products to conventional litigation through the courts.

The problem of too few competitors in the marketplace has been remedied voluntarily by some participants (Merrill Lynch and PaineWebber), but the majority of firms have resisted changes to their arbitration procedures, except to the extent that these firms relied on industry arbitration provided by the NASD or the NYSE. Because the NASD still hears arbitration claims subject to a firm's mandatory predispute arbitration agreement, many firms will not alter their policies unless forced by the market through the free flow of information to client-claimants and others.

The lack of competitors presents the greatest challenge to the efficient function of the claims market. Many industry employees might have only two options—unattractive NYSE arbitration (which has not yet succumbed to market pressures and may not ever, because, as with the courts, the NYSE has little to gain by attracting claims) and conventional litigation. This market barrier would easily be broken down by the Civil Rights Procedures Protection Act, which would ensure vertical competition and encourage the development of more horizontal competitors. The Civil Rights Procedures Protection Act is a crucial aspect of claims market reform because the act eliminates anticompetitive, inefficient, single-source claims markets.

Clearly, the market should be left to operate unfettered by excessive governmental regulation.[153] Securities industry firms should be allowed to fashion inventive solutions in an effort to preserve arbitration and make it more attractive for claimants. However, government must ensure the competitiveness of the market by expanding the market to all industry firms (ensuring adequate horizontal competition), by entering into the market itself (ensuring vertical competition), and by policing fair employment practices and dispute resolution standards as a regulator.[154]

D. Lack of Mobility

Congressional action on the Civil Rights Procedures Protection Act could also resolve the third, and perhaps most obvious, problem with mandatory arbitration of employment disputes: lack of employee mobility. The lack of employee mobility relates closely to the problem of too few competitors. The NASD rule change does not force its members to abandon mandatory arbitration agreements with their own employees. For industry employees whose firms mandate arbitration, there is no possibility of participating in the employment discrimination claims market. For example,

---

153. *See infra* Part V.D.

154. By establishing minimal standards, such as appealability of egregious decisions, for example, the government can ensure that employees are not selling their rights, or at least not selling them too cheaply. *Gilmer* may support the sale of certain statutory rights in return for employment, even when the employees do not understand that they are selling those rights. However, by removing mandatory arbitration agreements from the employment discrimination context, employers cannot force employees to sell their rights as a condition of employment, and thus employees may participate as more knowledgeable consumers in the marketplace.

Salomon Smith Barney employees recently issued a new employee handbook stating that employees must arbitrate all employment-related claims through industry arbitration. Salomon Smith Barney also stipulates in the agreement that employees must use NASD arbitration because the NASD will still hear employment discrimination claims under predispute arbitration agreements, whereas under NYSE rules, statutory discrimination claims are not eligible for arbitration pursuant to predispute agreements to arbitrate.

Salomon Smith Barney has also sought to maintain an advantage by creating a rule limiting damage awards. According to employment attorney Cliff Palefsky, who chairs the National Employment Lawyers Association's securities arbitration committee, the firm ran an "end around the NASD's rule-making process"[155] by stipulating in the handbook that "'arbitrator(s) shall not have the authority to award punitive or exemplary damages except where provided for by applicable statute' and that 'arbitrators can't make arbitrary or capricious' awards."[156] Palefsky has urged the NASD to refuse to accept arbitration cases brought under the new handbook rules.[157]

Although Salomon Smith Barney employees may be dissatisfied with the firm's new policies, many of these employees do not have the realistic option of leaving the firm. Often, employees in lower-paying jobs feel that they are expendable and, therefore, would not risk disclosing their displeasure with the policies. Even some highly skilled employees may not be able to transfer to a firm with more employee-friendly policies because of market changes or mergers that make their services less valuable in the market for employees.

The lack of mobility for Salomon Smith Barney employees arises because the firm has limited the options for its employees in the market for discrimination claims. As a general market principle, the lack of an adequate number of competitors and the lack of mobility of industry employees create a drag on the overall efficiency of the market. The actions by a large firm such as Salomon Smith Barney thus impose inefficient, or less efficient, outcomes on employees of other industry firms, as Salomon employees will be less able to exercise market choice by moving to another company. Salomon Smith Barney's actions are essentially anticompetitive, and market regulators

155. *SSB Keeps Arbitration Mandatory*, REGISTERED REPRESENTATIVE, July 30, 1999, at 24. "'I dare say that the arbitrators, when faced with that [prohibition on punitive and exemplary damages], would totally disregard it, as they should.'" *Id.* (quoting David Robbins, a New York securities attorney).

156. *Id.* (quoting the handbook). Salomon Smith Barney has not clarified what would constitute an "arbitrary or capricious" award, stating only that "'[w]e have worked diligently to develop a fair and lawful arbitration policy for our employees. It is our intent to comply with the rules and regulations of any forums.'" *Id.* (quoting Salomon Smith Barney's press office).

157. *See id.*

must step in to ensure that the firm's employees have real options in a competitive marketplace. By completely eliminating mandatory arbitration of employment discrimination claims through passage of the Civil Rights Procedures Protection Act, the federal government will provide a competitive market, and industry arbitration will make greater efficiency gains to the benefit of market participants.

E. Excessive Regulation

Finally, although I have stressed the importance of vertical competition and governmental regulation in the marketplace for claims, excessive regulation may also create a drag on market efficiency. Regulators should monitor the extent to which the imposition of regulations on industry employers increases administrative burdens. An increase in the administrative burden may not only increase the costs for arbitration, but may also slow the arbitration process, thus eroding key competitive advantages.

Consider the disclosure requirement I discuss above. Undoubtedly, enhanced disclosure requirements will increase administrative costs. However, informational benefits should offset these costs, resulting in overall efficiency gains. Nevertheless, if the disclosure requirement compels employers to furnish excessive amounts of information, employees could suffer information overload, causing them to treat the vast amount of information as equivalent to no information at all.[158] With this possibility in mind, regulators must pare down the disclosure requirements to include only the most essential information in the most intelligible format possible.

Another regulatory danger is that claims market regulation may become so excessive as to collapse under its own weight.[159] This might occur when the regulations become too numerous to enforce, require too much time and expense from regulators operating in a limited administrative capacity, or are not enforced because regulators simply view the regulations as overly burdensome or unfair. Regulators can avoid detrimental overregulation by working closely with the industry on the development of new regulations, and by allowing the industry to develop useful and creative solutions through self-regulation.[160]

158. *See* SUNSTEIN, *supra* note 100, at 284–85; *see also* Richard Craswell, *Interpreting Deceptive Advertising*, 65 B.U. L. REV. 657, 690–91 (1985).
159. *See* SUNSTEIN, *supra* note 100, at 277.
160. *See* Esty & Geradin, *supra* note 2, at 249–50.

CONCLUSION

In this Comment, I introduce the developing market for employment discrimination claims, noting some of the market barriers impeding the progress of the market, as well as some market protections that will promote the development of the market. The regulatory co-opetition model that I have introduced relies on the federal government to play an active role in ensuring that the market remains competitive and that employees are able to choose among fairly priced legal products. Since the general acceptance and inclusion of the mandatory arbitration clause, securities industry arbitration has been largely unresponsive to employee needs. Consequently, practically no employee with the possibility of pursuing litigation would choose arbitration. Rather than abandon arbitration, which still enjoys many natural advantages over litigation, the government and the securities industry must work together to develop a competitive discrimination claims market to produce more efficient arbitration systems. Employers and employees will both benefit from these efficiency gains (although, in the near term, employers might have to give up some advantages they enjoyed under the mandatory arbitration regime).

The market is not yet fully functioning. Many industry firms still require employees to arbitrate discrimination claims pursuant to mandatory arbitration clauses. Because horizontal market pressures on these companies are weak, governmental intervention is required to develop a truly competitive claims market. If the federal government steps in as a vertical competitor and regulator through the elimination of mandatory arbitration clauses, the resulting open, competitive, and regulated claims market will ensure that the benefits of arbitration are available to all securities industry employment discrimination claimants.